



COMMISSION OF THE EUROPEAN COMMUNITIES

# STUDIES

**The law of  
suretyship and  
indemnity in the  
United Kingdom of  
Great Britain and  
Northern Ireland  
and Ireland**

This study has been made in order to bring together the basic information necessary for the drafting of a Directive harmonizing the law of Suretyship in the Community.

It deals with suretyship and other personal guarantees governed by the laws of England and Wales, Scotland, Northern Ireland and Ireland. It includes a description of the types of suretyship covered and sets out the main similarities and differences which exist as between the various types in these countries.

It supplements the study which was published in 1971 (Competition Series, No 14) dealing with suretyship in the laws of the founder Members of the Community.

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**The law of suretyship  
and indemnity in the  
United Kingdom of Great Britain  
and Northern Ireland  
and Ireland**

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in

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STUDIES

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## Part I

### SURETYSHIP AND INDEMNITY IN BRITISH AND IRISH LAW

#### Chapter 1

##### SURETYSHIP AND INDEMNITY : BASIC CONCEPTS

###### I n t r o d u c t i o n

1. Territories covered - This study covers the following territories :
  1. England and Wales (England and Wales form a single legal unit; therefore when there is a reference to "England" it may be assumed that what is said applies to Wales as well).
  2. Scotland.
  3. Northern Ireland.
  4. The Republic of Ireland.
2. England and both parts of Ireland are Common Law countries and the law is normally the same in all these territories except where there is different legislation. The Scottish legal system is based partly on Roman Law but in the area of this study the law is often similar to that in England. For these reasons the study will deal primarily with England ; the other territories will be mentioned only where their law differs from that of England (1).
3. Terminology - The term "personal security" will be used in the same sense as in the Study prepared by the Max-Planck-Institut, (2) i.e. it covers all contractual devices that fulfil the same economic function as suretyship.

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(1) See pp. 2-5 of my study on the internal law of the United Kingdom of Great Britain and Northern Ireland in the field of property law (XIV/426/72-E) hereinafter cited as my "Report on Property".

(2) The Suretyship in the Law of the Member states of the European Communities, prepared by the Max-Planck-Institut für ausländisches und internationales Privatrecht (Hamburg 1973), paras. 1 and 2. This Study is hereafter referred to as the "Max-Planck-Institut Study".

4. A difficulty arises with regard to the term "guarantee". In the Max-Planck-Institut Study this term is used, with reference to Dutch and German law, to describe an undertaking which is not accessory in character, i.e. in which the guarantor is obliged to pay even if the claim against the principal debtor is not legally valid (1). This is in contrast to a normal suretyship in which the liability of the surety is generally co-extensive with that of the principal debtor so that if the debtor is not legally obliged to pay, the surety is not liable either.
5. The distinction between these two kinds of contract is fully recognised in English law; unfortunately, however, the terminology is different : the word "guarantee" is applied to the narrower undertaking and means the same thing as a suretyship. The wider undertaking is called a contract of indemnity. In this study, therefore, the term "guarantee" will not be used in the same sense as in the Max-Planck-Institut Study : it will be used to mean exactly the same thing as "surety". An undertaking which falls outside the definition of a guarantee will be called an indemnity (2).

#### S u r e t y s h i p ( G u a r a n t e e )

6. Suretyship (guarantee) is a contract where the surety (guarantor) undertakes to be answerable to the creditor for the liability of the principal debtor whose primary liability to the creditor must exist or be contemplated. There must therefore be an existing or contemplated obligation on the part of the principal debtor to the creditor and the validity of the contract of suretyship is normally dependent on that of the principal obligation.
7. It has been held (in Sutton & Co. v. Grey) (3) that a contract cannot be one of guarantee if the guarantor was connected with the creation of the primary obligation and derives a benefit from it. In that case a firm of stockbrokers agreed with Grey that the latter would be entitled to half the commission earned through clients he introduced and that he would be liable for half the losses sustained in regard to them. It was held that the contract was not one of guarantee since Grey derived a benefit from the creation of the original liability. It was consequently a contract of indemnity. For the same reason a del credere agent's contract is not one of guarantee (suretyship) (4).
8. It will be apparent from the definition given above that the primary obligation may be created either before or after the suretyship. Where it is created after the suretyship (i.e. where the suretyship is to guarantee future liability) it may be made in respect of a single specified transaction or for an indefinite series of transactions. In this latter case it is called a continuing guarantee : the surety may, for example, guarantee all debts contracted by the principal debtor in his dealings with the

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(1) Ibid. paras. 12 and 29.

(2) See below paras. 10-13, for definitions.

(3) (1894) 1 Q.B. 285.

(4) See para. 36, below.

creditor. The surety may, of course, limit his liability either by specifying a time limit or a financial limit. In either case difficult questions of construction may arise.

9. Scotland - In Scotland the general concept of suretyship is the same as in England and the above definition applies in Scotland as well as in England; however, there is a difference in terminology : the normal term for suretyship is "cautionary obligation" and the surety is called a "cautioner". The English terms are also used, however, and in this Report it will normally be more convenient to use English terminology with regard to all the systems of law under study.

#### I n d e m n i t y

10. The term "indemnity" is used in several senses. These are : first, in the widest sense it means an obligation to make good any loss suffered by the person indemnified. This loss may result from the failure of a third party to carry out his obligations towards the person indemnified or it may result from liability incurred by the person indemnified towards a third person. The obligation to indemnify may result from contract or from operation of law. One example of an indemnity in this sense is found in the law of suretyship itself : if the surety pays the debt to the creditor, he has the right to claim an indemnity from the debtor (1).
11. The second meaning of the term is limited to an obligation arising out of a contract. In this sense the term includes contracts of suretyship, many contracts of insurance and other contracts.
12. The third meaning is the narrowest. When used in this sense it is used in contrast to a contract of suretyship. Here it refers to a contract in which the indemnifier undertakes to make good any loss suffered by the person indemnified as a result of his entering into a given transaction. The difference between an indemnity (in this sense) and a suretyship is that the indemnity is an independent (primary) obligation; the suretyship is a collateral, accessory or secondary obligation. This distinction is discussed below. (2)
13. It should finally be mentioned that a contract which would be one of suretyship but for the fact that the "surety" has an interest in the principal obligation is also called an indemnity. This conflicts with the definition just given (third meaning) because in this case the obligation may be a collateral or secondary one. It is, however, convenient to include such a transaction in the concept of an indemnity (third meaning); therefore in this Report the term "indemnity" will be used in the third sense discussed above except that a transaction of the kind just mentioned will be included within the concept.
14. Finally, it should be said that it is not very easy to distinguish indemnity (in the third sense) from insurance. It is true that indemnity (in the wider sense) includes insurance ; in the narrow

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(1) See below, paras. 110-15.

(2) See below, paras. 16-22.

sense it presumably does not; but there is no clear authority as to exactly what is the criterion for distinguishing between them. This is partly because the law relating to indemnities is not very well developed - unlike the law of suretyship and insurance. It may not be very important in practice to make this distinction; but there are probably some situations in which it would have to be done : for example, it is probable (although there is no clear authority) that a contract of indemnity is, like a contract of suretyship, not a contract uberrimae fidei (1). A contract of insurance is. If, therefore there was a failure to disclose a relevant fact, the validity of the contract might depend on whether it was indemnity or insurance. If the courts had to determine into which category a given contract fell, it is probable that, if other indications failed, it would see whether a payment in the nature of a premium was made by the person insured/indemnified. If there was, it would be regarded as insurance; if not, it would probably be an indemnity.

15. Since the law of indemnity is much less developed than the law of suretyship this Report will concentrate on the latter. However, the differences will be pointed out where appropriate. Two important differences are : first, that an indemnity may be valid even though the "principal" obligation is invalid (e.g. for lack of capacity) (2); secondly, that there is no requirement that an indemnity be in writing (3).

#### A c c e s s o r y   C h a r a c t e r   o f   S u r e t y s h i p

16. Suretyship is an accessory, secondary or collateral contract (4). By this is meant that it cannot exist on its own : there must be some other contract (the principal obligation) to which it relates. This does not mean that the suretyship must always come into existence after the principal obligation. It is enough if the principal obligation is envisaged at the time when the suretyship is entered into. Of course, if the principal obligation never comes into existence, the suretyship will never be effective.
17. It follows from this that, as a general rule, the suretyship will be invalid if the principal obligation is invalid. This is the crucial distinction between suretyship (guarantee) and indemnity. An indemnity is not an accessory or collateral obligation. The indemnifier is primary liable. The difference between the two contracts can be best summed up as follows : a surety promises in effect : "If the debtor does not pay what he owes, I will pay it". The indemnifier says to the creditor : "If you suffer a loss as a result of this transaction, I will make good that loss".
18. The distinction between these two kinds of contract is especially important where the principal debtor is a minor. In the case of a contract of suretyship it has been held that the surety is not liable. This was the decision in the case of Coutts & Co. v.

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(1) See para. 72.

(2) See para. 19.

(3) See paras. 65 and 68.

(4) In this Report all these terms mean the same thing.



Browne-Lecky (1) in which the plaintiffs, a well known bank, lent money to a minor on an overdraft. There were two joint guarantors for the debt but the court held, first, that since the debtor was a minor the bank could not recover against him. (It is expressly provided by section 1 of the Infants Relief Act 1874 that a contract entered into by a minor for the repayment of money lent is "absolutely void"). Secondly, that, since the principal obligation was invalid, the guarantee was also invalid. The sureties were not, therefore, obliged to pay.

19. This case has been criticised (2) on the ground that all the parties knew that the principal debtor was a minor. However, there is an easy way round this rule of law : all the creditor has to do is to require that a contract of indemnity be entered into, instead of one of suretyship. If this is done, the indemnifier will be liable. The question whether a particular contract is one of indemnity or one of suretyship is decided by interpreting the intention of the parties. The mere use of the term "indemnity" is not in itself conclusive (3).
20. It should be mentioned that there are a number of decisions that seem to run counter to the principle of the accessory character of suretyship. These cases lay down that if a company enters into an ultra vires contract and one or more of the directors guarantees that contract, the guarantor will be liable even though the company will not (4). These cases may constitute an exception to the rule; but it is also possible that they could be explained on the ground that the true nature of the undertaking in them was indemnity not guarantee (5).
21. One can conclude that the law is not entirely settled on this point. One can, however, be fairly sure of one thing : if the principal contract is illegal (in the sense of being a criminal offence) or if, to the knowledge of the parties, it was entered into with a view to committing a criminal offence, or if it is immoral or otherwise contrary to public policy, then the guarantee will also be void. This would no doubt apply to a contract of indemnity as well.
22. Scotland - The law of Scotland is probably the same as that of England on this point, though there might be some differences of detail (6).

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(1) (1946) 2 All E.R. 207; (1947) K.B. 104. See also Stadium Finance Co. Ltd. v. Helm (1965) 109 Sol. Jo. 471.

(2) See E.J. Cohn, "Validity of Guarantees of Debts of Minors" (1947) 10 Modern Law Review 40 (a comparative study) and M.P. Furmston, "Infants' contracts - La Nouvelle Vague?" (1961) 24 Mod. Law Review 644.

(3) See Yeoman Credit Ltd. v. Latter (1961) 2 All. E.R. 294.

(4) See Yorkshire Railway Wagon Co. v. Maclure (1881) 19 Ch. D. 478; Garrard v. James (1925) 1 Ch. 616

(5) This view is borne out by the comments of Lawrence J. in Garrard v. James (1925) 1 Ch. 616 at 623 where he says that the true nature of the undertaking was that the defendants agreed that they would pay if the company did not.

(6) See Gloag and Henderson, p. 220 and Gow, p. 307.

## Chapter 2

### OTHER PERSONAL SECURITIES

#### J o i n t   D e b t o r s

23. In English law it is necessary to distinguish between three cases : joint debtors, several (separate) debtors, and joint and several debtors. Several (separate) debtors are debtors subject to separate obligations : e.g. D(1) agrees to pay C £10 and D(2) agrees separately to pay C another £10. There are two separate obligations (even though they may be contained in the same document) : each debtor is liable for only £10 but the creditor can get a total of £20.
24. If, however, D(1) and D(2) jointly agree to pay C £10, there is only one debt. C can recover this from either debtor (or both at the same time) but he cannot get more than £10 in total. If one debtor pays, the other is discharged. The creditor can choose which debtor to sue but the debtor being sued can normally have the other debtor joined to the proceedings as co-defendant. There is also a right of contribution between joint debtors : if one pays, he can demand that the other(s) pay his/their share(s). In the absence of an agreement in the contract, each joint debtor must pay an equal share.
25. Joint and several liability is in most ways similar to joint liability. If D(1) and D(2) agree jointly and severally to pay C £10 there is again only one debt but it is created by three promises : the several promise of D(1) to C, the several promise of D(2) to C, and the joint promise of D(1) and D(2) to C. Since there is only one debt, what has been said above concerning a joint debt applies here as well. There are, however, differences : if one joint debtor dies, his obligation does not pass to his personal representative (i.e. the person who succeeds to his estate) and the debt remains solely with the other joint debtor(s) (1). But if a joint and several debtor dies, the obligation does pass to his personal representative. (It is said that the several obligation passes to the personal representative and the joint obligation passes to the surviving joint debtor(s)). Another difference is that if the creditor sues one of the joint debtors and obtains a judgement against him, he cannot subsequently sue the other joint debtors, even if the judgement is unsatisfied (2). This is not the case with a joint and several debt. (It is said that though there is only one debt there are as many causes of action as there are promises. Therefore the other debtors can be sued on their several promises). If a judgement against a joint and several debtor is satisfied, the debt is discharged and the other debtors cannot be sued.

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(1) Compare the position where a joint owner of property dies : see my Report on Property Law, p. 24 (Ch. 2).  
(2) For this reason the creditor would be well advised to sue all the joint debtors together.

26. Joins debts (and joint and several debts) have some similarities with guarantees but there are also differences. A surety (guarantor) is normally entitled to be repaid the whole amount by the principal debtor if the surety is obliged to pay the creditor; a joint debtor is normally entitled to only half (if there are two joint debtors). However, this rule can be varied by agreement.
27. If the creditor releases one joint debtor, the others are also released. Likewise, in the case of suretyship, if the creditor releases the principal debtor, this also releases the surety. But if the creditor releases the surety, this does not affect the obligation of the principal debtor.
28. Other differences are :
- (1) A surety is not obliged to pay if the principal debtor is not liable, even if he escapes liability by reason of his incapacity; but if one joint debtor escapes liability by reason of such a defence, the liability of the other(s) is not affected.
  - (2) Under the Statute of Frauds a contract of guarantee must be in writing; this rule does not apply to a joint debt.
  - (3) If one joint debtor dies the liability does not pass to his personal representative. (This is not true in the case of a joint and several debtor). But in the case of suretyship the liability of both the principal debtor and of the surety passes to their personal representatives on their death.
  - (4) If the creditor obtains a judgement against one joint debtor he cannot sue the other (even if the judgement is unsatisfied) (1). But, in the case of suretyship, the fact that the creditor has obtained a judgement against the principal debtor does not (provided the judgement is unsatisfied) prevent him from suing the surety; the same applies if the creditor first sues the surety (2).
29. There is no doubt that a joint debt can (and sometimes does) fulfil the same economic function as a guarantee. However, as joint debts are excluded from the Max-Planck-Institut Report, they will be excluded here too.

NOTE : For citations of cases on the points mentioned in this section see : Sutton and Shannon on Contracts (7th ed. 1970), pp. 536-42.

30. Scotland - In Scotland the position is somewhat different. There the debtors may be bound either pro rata or in solidum. If they are bound pro rata each is liable to the creditor for his share of the debt only. Unless the contrary is agreed, each is liable for an equal share. If they are liable in solidum, each is liable to the creditor for the whole debt; but if one debtor pays the whole

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(1) This is not the case in regard to a joint and several debt.

(2) See Rowlatt, p. 66, citing Bermondsay v. Ramsey (1871) L.R. 6 S.P. 247 at 257.

debt, he can claim against the other debtors for their share. Among themselves, debtors in solidum are liable for an equal share unless the contrary is agreed.

31. It will be seen from this that liability in solidum in Scottish law is equivalent to joint liability in English law. Unfortunately, however, there is a terminological difficulty : in Scots law if A and B agree to be bound "jointly" this means that they are bound pro rata. If they agree to be bound "jointly and severally" they will be liable in solidum. Thus the English terminology has been given a different meaning in Scotland from what it has in England.
32. If the parties have not made clear whether the obligation is pro rata or in solidum there is a general presumption that it is pro rata. This presumption applies in the case of a cautionary obligation (suretyship). There are, however, a number of important exceptions where the presumption is that the obligation is in solidum. Thus in the case of a negotiable instrument liability is in solidum and if two or more persons together order goods or services, they are liable in solidum.
33. As in the case of a joint obligation in English law, if the creditor frees one debtor in solidum, he discharges the others unless he expressly reserves his right against them (in which case the remaining debtors retain their right for a contribution from the debtor who has been freed).
34. The English distinction between, on the one hand, joint liability and, on the other hand, joint and several liability does not seem to apply in Scotland.

NOTE : For further discussion see : Gow, pp. 21-2; Gloag and Henderson, p. 35.

#### D e l C r e d e r e A g e n t s

35. A del credere agent is an agent employed to sell goods who agrees (usually in return for a greater commission) to guarantee that the buyers of the goods will pay for them. At one time it was thought that the agent's liability was primary (independent) (1) but it now seems clear that it is secondary (accessory) only (2). Thus the agent is liable only if the buyer fails to pay what he is legally obliged to pay. He is also not liable for a breach of contract by the buyer other than a refusal to pay the price of the goods. Thus it has been held that a del credere agent is not liable if the buyer refuses to accept the goods (3). One can, therefore, conclude that the del credere agent is merely a guarantor of the solvency of the buyer.
36. The contract is not, however, strictly speaking one of guarantee (suretyship) because the agent is not connected with the obligation he guarantees : he negotiated it and derives a benefit (his commission) from it. Thus, in spite of the fact that his

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(1) Grove v. Dubois (1786) 1 Trem Rep. 112 (per Lord Mansfield).

(2) Morris v. Cleasby (1816) 4 M & S 566 (per Lord Ellenborough).

(3) Thomas Gabriel & Sons v. Churchill & Sim (1914) 3 K.B. 1272.

liability is secondary, the obligation is regarded as a form of indemnity (1). The importance of this is that the requirement (laid down in the Statute of Frauds) that a contract of guarantee (suretyship) must be in writing does not apply (2). The existence of a del credere agency can be proved without writing : it can in fact be implied from the conduct of the parties (3).

NOTE : See further : G.H.L. Fridman, The Law of Agency (3rd ed. 1971) pp. 29-30.

G u a r a n t e e o f a B i l l o f E x c h a n g e  
o r a P r o m i s s o r y N o t e

37. This topic was excluded from the Max-Planck-Institut Report in view of the fact that the law of the original Six Member States is virtually uniform by virtue of the League of Nations Conventions of 1930 and 1931 (signed in Geneva). The U.K. is not, however, a party to these conventions (nor is Ireland) and the aval is not recognised to the same extent in the U.K. and Ireland. Thus it has been held in England that an aval given on behalf of the acceptor is not effective (4). The endorsement by a stranger to the bill does have the effect of an aval as regards those who held the bill subsequently (i.e. after the endorsement) but the signer incurs no liability to those who were parties before him.
38. This is, however, a complex topic and it would probably be undesirable to attempt to harmonise the law on this matter except in the context of the harmonisation of the law of negotiable instruments in general. It will therefore be excluded from this Report.

T h e " P o r t e - F o r t "

39. The porte-fort is described in the Max-Planck-Institut Report as it applies in the law of France and certain other countries following the French tradition. (This term is incorrectly translated in the English version of the Max-Planck-Institute Report as "bailment"(5). There is no equivalent in English law, though the same result could probably be obtained by express agreement.

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(1) See above, para. 7.

(2) Couturier v. Hastie (1852) 8 Exch. 40 (reversed on other grounds (1856) 5 H.L. Cas. (673); Wickham v. Wickham (1855) 2 K & J 478; Fleet v. Murton (1871) L.R. 7 Q.B. 126 at 132-3 (per Blackburn J.); Sutton & Co. v. Grey (1893) 69 L.T. 354 at 355 (per Bowen L.J.) (affirmed (1894) 1 Q.B. 285).

(3) Shaw v. Woodcock (1827) 7 B & C 73.

(4) Jackson v. Hudson (1810) 2 Camp. 477 at 478 (approved in Steele v. McKinlay (1880) 5 App. Cas. 754 at 772).

(5) For the meaning of the term "bailment" see my Report on Property, pp. 54-5 (Chap. 5).

40. English law does deal with the situation where one person pretends to have the authority to contract on behalf of a "principal" when in fact he has no such authority. If the "agent" enters into a contract with a third person on behalf of the "principal" the position is as follows : if the "principal" ratifies the contract, the "agent" incurs no liability; otherwise there is no contract with the "principal" but the "agent" is obliged to compensate the third party for a breach of warranty of authority. (This is an implied warranty that he had the authority of the "principal" to contract). The agent is liable even if he acted in good faith and without negligence, but such liability can exist only if the third party was in fact deceived : if he knew that the "agent" had no authority, the latter is not obliged to compensate him. It seems, from the description in the Max-Planck-Institute Report that the "porte-fort" is different from the warranty of authority in this respect.

NOTE : For a discussion of the warranty of authority see G.H.L. Fridman, The Law of Agency (3rd ed. 1971), pp. 179-83.

#### The "Credit Order"

41. There is no precise equivalent in English law to the "credit order" of German and Italian law described in para. 19 of the Max-Planck-Institut Report. It should, however, be noted that in English law a principal is obliged to indemnify his agent for any loss suffered by the latter as a result of action taken by him within the scope of his duties as an agent. This obligation arises automatically by operation of law unless the parties agreed to the contrary. It is possible, therefore, that this doctrine of the law of agency would produce the same result as the provisions of German and Italian law discussed in the Max-Planck-Institut Report (1).
42. There is another institution of English law that should be mentioned although it seems quite different from the "credit order". This is the commercial letter of credit. Say A in London wishes to buy goods from B in Hamburg. A may agree to open a credit with a bank in Hamburg for the price of the goods. A will then arrange with his bank in London to arrange with a bank in Hamburg to give B a letter of credit for the sum in question. This means that the Hamburg bank agrees to accept a bill drawn by B for the sum in question in exchange for documents giving title to the goods. A is of course obliged to reimburse the bank. I assume that letters of credit are also recognised in other Community countries. Since they are, however, quite different from guarantees they need not be considered further.

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(1) D : art. 778 BGB; I : art. 1958, para. 1 cod. civ. For a discussion of the principal's duty to indemnify the agent in English law see G.H.L. Fridman, The Law of Agency (3rd ed. 1971), pp. 148-9.

## G u a r a n t e e   I n s u r a n c e

43. There are various kinds of guarantee insurance, e.g. a fidelity bond (insurance against the dishonesty of an employee), insurance for the due completion of a contract and debt insurance. The economic function of all these kinds of insurance is similar to that of a suretyship : to ensure that the person insured does not suffer loss if some other person does not carry out his contract.
44. Legally, however, suretyship and insurance are two quite different things. A contract of suretyship is a collateral obligation in which the surety's liability is only secondary; an insurance contract creates an independent obligation in which the insurer's obligation is primary. Other differences include the following :
1. In the case of suretyship there is only one debt and if the surety pays, the debt is discharged. In the case of insurance there are two obligations (though that of the insurer only arises if the debtor fails to pay) and payment by the insurer does not discharge the debt.
  2. If the surety pays the debt he has a direct right against the debtor; if the insurer pays, he is only subrogated to the rights of the insured against the debtor.
  3. A contract of suretyship must be in writing (Statute of Frauds); a contract of insurance may be oral.
  4. A contract of insurance is a contract of utmost good faith (uberrimae fidei); it is generally considered that a contract of suretyship is not (1).
  5. In the case of suretyship the surety is not liable if the contract creating the original debt is invalid; but the insurer must normally indemnify the insured for the loss he suffers even if the debtor is not liable.
45. It is not always easy in practice to tell whether a particular contract is one of suretyship or insurance. The intention of the parties is the vital thing. Another factor which may be important is that insurance is normally undertaken for commercial motives while suretyship is often based on personal friendship between the surety and the debtor. However, this is not always true and there is nothing to prevent a person entering into a contract of suretyship for purely commercial reasons.
46. The distinction between insurance and indemnity has already been considered (2).

NOTE : See further : Sidney Preston & Raoul Colinvaux, The Law of Insurance (2nd ed. 1961), pp. 358-366; Halsbury's Laws of England, vol. 22, Insurance, pp. 401-2; Charlesworth, pp. 262-4; Rowlatt, pp. 9-11.

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(1) Hals., pp. 415 and 495; Charlesworth, pp. 263-4; Rowlatt, p. 10 (but see Preston & Colinvaux (cited above), p. 359).  
(2) See above, para. 14.

## Chapter 3

### FORMATION (CONDITIONS FOR VALIDITY)

47. Suretyships and indemnities are, of course, governed by the general law of contract and the normal rules concerning offer and acceptance apply. Capacity to furnish a personal security is also governed by the general law of contract. It is not necessary to consider all these rules here : all that need be done in this chapter is to discuss those rules that are peculiar to personal securities, or are particularly important, or are likely to be unfamiliar to lawyers from other Member States.

#### C a p a c i t y

48. Under English law a minor lacks capacity to enter into a contract of suretyship and a purported contract of suretyship entered into by a minor cannot be ratified by him when he comes of age (1). If a person who has recently come of age agrees to act as surety for his parents (or someone who stands in loco parentis towards him) there is a presumption (which may be rebutted) that undue influence exists. The effect of this is to make the contract voidable (2).
49. Scotland - In Scottish law a minor can undertake a cautionary obligation if he acts with his curators but it will be enforceable against him only in certain circumstances (3).
50. A woman has full capacity to act as a surety, either for her husband or for anyone else. There is no presumption of undue influence if a wife agrees to stand surety for her husband.
51. In the past the position under British law was that if a company entered into a contract (e.g. of suretyship) which was outside its powers as laid down in its memorandum of association, the contract was void (ultra vires doctrine). This, however, has now been altered by the Directive of 9.3.1968 on Company Law.

#### C o n s i d e r a t i o n

52. The doctrine of consideration is peculiar to English law and the systems derived from it. It is found in England and both parts of Ireland but not in Scotland. It is a general doctrine of the law of contract and applies to guarantees as well as to other kinds of contract. It will first be considered in general terms and then it will be shown how it applies to contracts of guarantee.

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(1) See the Infants Relief Act 1874, ss. 1 and 2. (This also applies in Ireland).

(2) See Holden, p. 245.

(3) See Gow, p. 309.



53. The general rule is that a contract is not enforceable by action unless there is consideration. The only exception is a contract by deed. A deed is a document that is signed, sealed and delivered by the person bound. This requirement is therefore, more than a mere requirement of writing since a document that is not, for example, sealed by the person bound is not a deed (1).
54. The general principle of English law is that a promise as such is not enforceable (except in the case of a deed) but a bargain is enforceable. For a bargain to exist there must be consideration on each side. Thus if my promise to pay £100 is to be enforceable against me, there must be something on your part in return. This is the consideration for my promise. Consideration may consist of either a promise on your part (executory consideration) or an act or forbearance on your part (executed consideration). Thus if I promise to pay you £100 in return for your promising to paint my house, there is a bargain : my promise is matched by your promise. You can enforce my promise because of the (executory) consideration given for it. If I promise to pay you £100 in return for your painting my house (not promising to paint it) the consideration is not a promise but an act (executed consideration) and my promise is enforceable only when the act is done. I might equally promise to pay you £100 if you do not do something (e.g. if you do not enforce a claim you have against a third person). This too is executed consideration. The act must, of course, be something done at the request (express or implied) of the promisor.
55. The consideration must be of some value but it need not be in any way equivalent in value to the promise that is being enforced. There is no doctrine of laesio enormis (lesion) in English law. The law is concerned only with whether there was a bargain, not whether it was a fair bargain. It should also be emphasised that the consideration need not benefit the party making the promise. If I agree to pay you £100 in return for something which benefits a third party, that is consideration for my promise.
56. A promise to do something which you are already under a general legal obligation to do is not, however, consideration. Nor is it consideration if you promise me to do something which you have already contracted with me to do. Say you owe me £100. If I say that I will accept £90 in full settlement and you pay me the £90, I can still sue you for the other £10. This is because there is no consideration for my promise to forgo the remaining £10 : you were already under an obligation to pay me the £90. If, however, you agree to paint my house or give me something in exchange for accepting £90 in final settlement, there is consideration. Likewise if you owe me £100 payable next week, and you offer to give me £90 payable now, then there is consideration because I am getting money now when you were obliged to pay me only by next week.

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(1) It should be mentioned that a seal need not be of wax and today a circular red wafer can be glued to the paper.

57. Two exceptions to what has been said should be mentioned. First, if a debtor agrees with all his creditors that he will pay each one of them so much in the pound and they accept, (composition agreement) this is binding though there is no consideration. Secondly, if you owe me £100 and I agree with a third person to accept £90 from him in full satisfaction of the debt, then I am also bound and cannot claim the remaining £10 from you. These two exceptions are anomalous but there are obvious practical reasons for them.
58. It should also be mentioned that past consideration is not good consideration. Thus if I promise to give you £100 in return for your having painted my house, my promise is not enforceable because the act had already taken place before my promise was made.
59. These are the general principles of consideration. They apply to contracts of guarantee just as much as to other kinds of contract. If the suretyship agreement is in a deed, no problems of consideration arise; otherwise the creditor must give consideration to the surety in return for his obligation to guarantee the debt. Frequently the consideration will be the granting of credit to the principal debtor. Thus the surety may agree with the creditor that if the latter grants credit to the principal debtor, he will stand surety for the debt. Since past consideration is no good, however, the agreement with the surety must precede the granting of credit. Here the surety is guaranteeing future debts. It is also possible that the creditor will demand that, in return for granting future credit to the principal debtor, the surety must guarantee both past and future debts. This agreement is fully enforceable.
60. Another possibility is that the creditor will agree not to take legal proceedings during a certain period of time to recover a debt already due in return for the surety agreeing to guarantee the debt. This is also good consideration. If, however, the surety agrees to guarantee a debt without obtaining any consideration in return, his promise is unenforceable. It should be emphasised again that it is not necessary for the surety to obtain any personal benefit from the arrangement : it is enough if the creditor agrees to something that benefits the principal debtor. The consideration must, however, come from the creditor : if the principal debtor agrees to pay the surety in return for his undertaking the suretyship, there is no obligation towards the creditor which the latter can enforce.
61. The distinction between executed and executory consideration is important in the case of suretyship. If S agrees to become a surety in return for C's promising to grant credit up to a certain sum to D, there is executory consideration and the agreement is binding immediately. But if S agrees that he will be surety if C gives credit to D, this is a case of executed consideration. C does not promise that he will give credit and until he actually does give the credit there is no consideration and S is not bound. The point is more important where S agrees to guarantee both past and future debts in consideration of the granting of further credit. Here S's promise is not enforceable unless and until further credit is actually granted. If further credit is never granted (possibly because D decides he does not want it) S will not be liable for the past debts.

62. Finally it should be mentioned that under section 3 of the Mercantile Law Amendment Act 1856 it is not necessary for the consideration to be mentioned in the written document constituting the agreement of suretyship.

NOTE : See further : Rowlatt, chap. 2; Halsbury, pp. 419-23.

63. Scotland - The doctrine of consideration does not apply to Scotland.

#### W r i t i n g

64. Contracts of suretyship must be in writing. This is laid down by section 4 of the Statute of Frauds 1677. This provides :

"No action shall be brought 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."

This statute, which originally applied to other kinds of contract besides a contract of suretyship (1), was an important modification of the English common law, which did not require any kind of contract to be in writing (except contracts by deed).

65. This provision covers all contracts of guarantee (suretyship); it also covers certain contracts that would not normally be regarded as guarantees. The word "miscarriage" in the Statute could apply to a tort (delict) as well as a breach of contract and consequently an agreement to be answerable for loss caused by the tortious act of another would also come within the Statute. But if we put this case on one side, it can be said that if the contract is not one of guarantee, it does not come within the Statute. Thus a joint debt does not come within the Statute; nor does a contract of insurance. A contract of indemnity is also outside the scope of the Statute. In fact in any case in which the liability of the person bound is primary and not secondary the Statute will not apply. Moreover, if a guarantee is an incident in a wider transaction or is given to protect a proprietary interest of the guarantor, it also does not come within the Statute. For this reason the promise of a del credere agent to be responsible to the principal for the price of the goods sold does not need to be in writing (2). The main object of the contract between the del credere agent and his principal is to settle the terms on which the agent will be employed and the purpose of the guarantee provision is to ensure that the agent will exercise greater care in choosing the persons to whom he sells the principal's goods.

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(1) The Statute of Frauds also applied to contracts for the sale of land and this provision was re-enacted by s.40 of the Law of Property Act 1925 and is still applicable. The provisions of the Statute that required certain other kinds of contract to be in writing were repealed by the Law Reform (Enforcement of Contracts) Act 1954.

(2) See above, para. 36.

66. It is important to note that the effect of the Statute is not to make an oral contract void but merely to make it unenforceable. It is therefore an evidentiary, not a formal, requirement; this has important consequences in private international law (1). Another consequence of the evidentiary nature of the Statute is that if money is paid under an oral guarantee it cannot be recovered (2).
67. To comply with the Statute the document must identify the parties and state the terms of the agreement. It need only be signed by the party against whom it is being enforced but the other party must be named or otherwise identified. The doctrine of consideration applies to a written contract as much as to any other (except a contract by deed) but the document need not state what the consideration is. This can be proved by oral evidence. This rule is the result of section 3 of the Mercantile Law Amendment Act 1856. A written note to the creditor, signed by the surety, offering to guarantee a particular debt is sufficient. It does not matter that it is in the form of an offer, provided the offer was subsequently accepted by the creditor. Nor does it matter if the note was written after the contract was entered into. The Statute will, therefore, be complied with if the surety writes a letter to the creditor, after the guarantee is entered into, and mentions in the letter the terms that were agreed upon. Terms that are implied by law or are customary need not be stated.
68. It has already been said that a contract of indemnity is outside the scope of the Statute (because the indemnifier undertakes primary, not secondary liability). This is, of course, anomalous : the purpose of the Statute of Frauds is to protect the surety and, since the indemnifier undertakes even greater liability than the surety, it would be logical if he too benefited from the protection. There is, however, one special case in which he does. This is if the principal contract is one of hire-purchase, conditional sale or credit-sale which comes within the Hire-Purchase Act 1965. This Act has various provisions to protect someone who acts as a surety for the hirer/buyer and these provisions apply to an indemnifier as well. (See the definition of a "contract of guarantee" in section 58(1). Section 22(1)(b) of the Act contains a requirement of writing similar to that of the Statute of Frauds and this consequently applies to indemnities as well if they come within the scope of the Act. The provisions of the Act are considered in more detail below (3).

NOTE : See further, Sutton & Shannon on Contracts (7th ed. 1970) Ch. 10; Rowlatt, Ch.3.

69. Ireland - The Statute of Frauds 1677 does not apply in Ireland. However, identical provisions apply in both parts of Ireland by virtue of the Statute of Frauds (Ireland) 1695, section 2 (4).

(1) See below, para. 122.

(2) See Rowlatt, p. 30 and cases cited at note (g). In the case of a contract for the sale of land (to which the statute also applies) there is a rule that writing is not necessary if there has been part performance. But this rule probably does not apply to contracts of guarantee; see Maddison v. Alderson (1833) 8 App. Cas. 467 at 474 (H.L.). See further, Sutton & Shannon on Contracts (7th ed. 1970), p. 254.

(3) See below, paras. 77-84.

(4) This is a statute of the Irish Parliament.

The Mercantile Law Amendment Act 1856 applies in both Northern Ireland and the Republic.

The Hire-Purchase Act 1965 does not apply in Ireland. Similar provisions apply in Northern Ireland by virtue of the Hire-Purchase Act 1966 (N.I.). The position in the Republic is slightly different : see the Hire-Purchase Acts 1946 and 1960 (Irish Republic).

70. Scotland - The Statute of Frauds does not apply to Scotland but similar provisions were laid down by section 6 of the Mercantile Law Amendment (Scotland) Act 1856. This reads :

"... all guarantees, securities or cautionary obligations made or granted by any person for any other person... shall be in writing, and shall be subscribed by the person undertaking such guarantee, security or cautionary obligation... or by some person duly authorised by him... otherwise the same shall have no affect."

The exact meaning of this is controversial and Scottish writers do not all take the same approach to it (1). However, it is probable that in general it means the same as the English Statute of Frauds; but there may be differences of detail. The Hire-Purchase Act 1965 does not apply in Scotland but similar provisions are found in the Hire-Purchase (Scotland) Act 1965.

#### F r a u d , M i s r e p r e s e n t a t i o n a n d N o n - d i s c l o s u r e

71. Like any other contract, a contract of suretyship is voidable on the ground of fraud or misrepresentation. In the case of suretyship, however, it is necessary that the creditor (not the principal debtor) either was a party to the fraud or misrepresentation or had knowledge of it. If either of these conditions is fulfilled the surety can avoid the contract notwithstanding the fact that the creditor entered into a transaction in reliance on the suretyship (2).
72. In the past there were some doubts whether or not mere non-disclosure made a contract of suretyship voidable, i.e. whether suretyship was a contract uberrimae fidei. It now seems settled that it is not (3) but the courts often seem willing to regard a

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(1) Compare Gow, pp. 304-7 with Gloag & Henderson, p. 221.

(2) See Mackenzie v. Royal Bank of Canada (1934) A.C. 468; Spencer v. Handley (1842) 4 M & G 414. As to misrepresentation, see the Misrepresentation Act 1967.

(3) Hamilton v. Watson (1845) 12 Cl. & F. 109; North British Insurance Co. v. Lloyd (1854) 10 Exch. 523; Railton v. Matthews (1844) 10 Cl. & F. 934; London General Omnibus Co. v. Holloway (1912) 2 K.B. 72. See also Seaton v. Heath (1899) 1 Q.B. 782, 793, reversed (1900) A.C. 135 without affecting this point; and Workington Harbour, etc. v. Trade Indemnity Co. 49 Ll.L.R. 430; reversed sub.nom. Trade Indemnity Co. v. Workington Harbour, etc. (1937) A.C.1.

partial disclosure as tantamount to misrepresentation and if the surety is given to understand that there are no unusual risks involved the contract could be voidable for misrepresentation if it turns out that this is not the case. The courts appear to take an especially strict view in the case of a fidelity guarantee (guarantee for the good conduct of an employee) and in one case it was held that the surety was not liable since the employer had failed to disclose previous misconduct on the part of the employee (1).

#### R e v o c a t i o n

73. In considering the question of when the contract becomes binding and whether the surety can revoke his promise, it is again necessary to distinguish between executory and executed consideration. In the case of executory consideration the creditor makes a promise in return for the surety's promise and the contract is binding as soon as agreement is reached. This is a bilateral contract : there are obligations on both sides. In the case of executed consideration, however, the surety asks the creditor to do something and promises that if he does, the surety will undertake his obligations. Here the creditor does not himself promise anything; he is merely informed that if he does something (e.g. grants further credit) the surety will undertake certain obligations. In this situation there is no binding contract until the creditor does what he is asked; there is merely an offer by the surety which the creditor can accept by doing what he has been asked. Until this happens the surety can withdraw his offer by informing the creditor. The offer is always revocable at this stage because there is no consideration until the creditor has acted.
74. What has been said in the previous paragraph is concerned with the formation of the contract : the time at which it becomes binding. The problem whether a continuing guarantee can be revoked after it has been in operation for a certain length of time raises different questions. A continuing guarantee is one in which the surety promises to guarantee any debts that may exist from time to time as regards a particular debtor. The problem here is to decide whether the guarantee is one transaction or a series of transactions. The nature of the consideration could be relevant here : if the consideration is the granting of credit to the debtor it could be that the parties intended that the granting of each advance to the debtor would be consideration merely for the guaranteeing of that advance. In this case there is not in fact a continuing contract but a continuing offer by the surety to guarantee each advance as it occurs. This offer is accepted by the granting of the advance. Clearly, if this is the case the surety can at any time withdraw his offer as regards future advances (i.e. those which have not yet been made).

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(1) London General Omnibus Co. v. Holloway (1912) 2 K.B. 72.

75. The whole matter, of course, depends on the intention of the parties. In construing their intention in doubtful cases, however, the courts may also consider whether the creditor has entered into an irrevocable transaction in reliance on the suretyship. If the creditor's obligations can be terminated, it would not prejudice him if the surety were also able to terminate his obligations (on reasonable notice) since, in this case, the creditor could protect himself by terminating his transaction as well. An example might make this clearer : a fidelity guarantee is a form of suretyship in which the surety guarantees to an employer the honesty and good behaviour of an employee. If the contract of employment is terminable at, say, a month's notice, it would not be unreasonable to construe the suretyship agreement (if it does not expressly deal with the matter) as giving the surety the right to terminate his obligations on a similar period of notice. The employer can then protect himself by dismissing the employee. (It is assumed that the consideration in this case was the appointment of the employee).
76. The death or insanity of the surety will revoke the guarantee provided the creditor is informed and the guarantee is revocable under the principles just discussed.

#### H i r e - P u r c h a s e   a n d   C o n s u m e r   C r e d i t

77. In recent times the British Parliament has pursued a policy of giving special protection to consumers who purchase goods on credit. Various statutes have been passed to give effect to this policy, the current ones in England being the Hire-Purchase Acts of 1964 and 1965. The main principles of these Acts were discussed in my previous Report (1). The 1965 Act also contains provisions relating to contracts of guarantee or indemnity where these contracts are entered into in relation to a hire-purchase agreement, conditional sale agreement or credit sale agreement which is itself within the scope of the Act. At the end of 1973, however, a bill (called the Consumer Credit Bill) was introduced into the U.K. Parliament with the object of reforming the law in this area so as to strengthen the position of the consumer still further. The Consumer Credit Bill has not yet (2) become law but will probably do so in the course of 1974. When it comes into operation it will apply to the whole of the U.K. (England, Scotland and Northern Ireland) and the present legislation will be repealed. In view of this the present law in England will be considered briefly (the law in Scotland and Northern Ireland is similar) and then the main provisions of the Bill will be discussed in so far as they relate to guarantees and indemnities. The discussion of the new law must, however, be fairly tentative since it is possible that the Bill will be amended by the Legislature. Please note also that changes in the Bill may mean that the references given in this Report to specific clauses may no longer be correct (3).

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(1) See my Report on Property, pp. 95-99a.

(2) February 1974.

(3) The references given below are to the Bill in the form in which it was after it had been amended by Standing Committee D of the House of Commons (5 February 1974).

78. The Hire-Purchase Act 1965 - Section 58 (1) of this Act contains a definition of a contract of guarantee for the purposes of the Act which provides that a contract of guarantee, in relation to a hire-purchase, conditional sale, or credit sale agreement, means :

"a contract, made at the request (express or implied) of the hirer or buyer, either to guarantee the performance of the hirer's or buyer's obligation under the hire-purchase agreement, credit sale agreement or conditional sale agreement, or to indemnify the owner or seller against any loss which he may incur in respect of that agreement, and "guarantor" shall be construed accordingly."

As a result of this the term "guarantee" when used in the Act includes an indemnity.

79. The main provisions of the Act concerning "contracts of guarantee" so defined are :

1. The contract must be evidenced by a note or memorandum in writing signed by the guarantor (or another person authorised by him) (1). Such a requirement already existed as regards contracts of suretyship under the Statute of Frauds; the effect of the 1965 Act is to extend it to contracts of indemnity within its scope.
2. Seven days after the making of the contract of guarantee or the hire-purchase agreement (whichever is the later) the guarantor must be given a copy of the hire-purchase agreement and of the note or memorandum evidencing the contract of guarantee. These copies must comply with certain provisions concerning legibility laid down by Regulations made under the Act. Failure to comply with these requirements makes the guarantee unenforceable unless a court decides that the guarantor was not prejudiced by such failure (2). There are certain other documents copies of which must be given to the guarantor upon request (3).
3. If the hirer exercises his statutory right to cancel the hire-purchase contract, an associated contract of guarantee (or indemnity) is deemed never to have had any effect (4).
4. Various other provisions giving protection to the consumer also extend to the guarantor; in particular if the owner recovers the goods unlawfully (i.e. contrary to section 34 (1)), the guarantor has the right to recover from the owner all sums paid by him under the guarantee (5). It is also provided that if the owner takes legal proceedings under the Act to recover the goods, the guarantor must be made a party to the proceedings (6).

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(1) S.22 (1)(b).

(2) S.22 (1),(2) and (3).

(3) S.23.

(4) S.14 (1).

(5) S.34 (2).

(6) S.35 (2).



80. One problem raised by this Act, however, is that it is not expressly stated that the liability of the guarantor cannot be greater than that of the hirer. This is important because there are limits to the maximum liability of the hirer. Under the common law principle of the accessory character of suretyship, a guarantor in the normal common law sense would probably be protected; but an indemnifier (included under the statutory definition of "guarantor") would not be. If the owner were to recover more from the indemnifier than he could from the hirer, could the indemnifier claim reimbursement from the hirer? The answer is not entirely clear but if this could be done the statutory protection of the hirer might be undermined.

NOTE : See further on this topic Goode, pp. 504-8.

80a. Scotland - The Hire-Purchase Act 1965 does not apply in Scotland but similar provisions are found in the Hire-Purchase (Scotland) Act 1965.

80b. Northern Ireland - The Hire-Purchase Act 1965 does not apply in Northern Ireland but similar provisions are found in the Hire-Purchase Act 1966 (a statute of the Northern Ireland Parliament).

80c. Republic of Ireland - The law in the Republic is slightly different : see the Hire-Purchase Acts 1946 and 1960 (Republic of Ireland).

81. The Consumer Credit Bill - The scope of the Bill is wider than the previous legislation. The agreements covered by it are defined in some detail (1) but in general terms one can say that, subject to certain exceptions, all consumer credit transactions up to £5000 in which the debtor is not a corporation (including hire-purchase, credit sale and conditional sale) are covered by the Act. This applies both where the credit is granted to finance a particular transaction and where the debtor is free to use the credit as he pleases.

82. The Bill provides that a security agreement must be in writing and it also makes provision for Regulations to provide for the form and content of the instrument creating it (2). The instrument must be signed by the surety personally (3). A copy must be delivered to him within seven days of its being made and there is a like provision for delivery of a copy of the principal agreement (4). Failure to comply with any of these provisions makes the agreement unenforceable unless a court order is obtained (5). The surety is also entitled to obtain certain documents on request (6).

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(1) See clauses 8-19.

(2) Cl. 100 A "security" includes both a suretyship and an indemnity : see clause 171(1).

(3) Cl. 100 (4)(d).

(4) Cl. 100 (4)(b) and (c).

(5) Cl. 100 (5).

(6) Clauses 103-5.

83. Clause 108(1) of the Bill expressly states that the creditor or owner cannot by enforcing a security obtain a greater benefit than he would get if the principal transaction were carried out by the debtor/hirer to the extent that would be enforceable under the Act. This applies to both a suretyship agreement and an indemnity. There is, however, one exception : clause 108(6) states that an indemnity given in a case where the debtor/hirer is a minor is to be enforced to the extent that it would be if the minor were of full capacity. This preserves the common law rule (1).
84. Republic of Ireland - The Consumer Credit Bill does not, of course, apply to the Republic.

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(1) See para. 19.

## Chapter 4

### EXTENT AND EXTINCTION OF GUARANTOR'S LIABILITY

#### N o n - S u b s i d i a r y C h a r a c t e r

85. The surety is liable as soon as the debtor makes default (but not before). Unless there is provision to the contrary in the contract of suretyship, the creditor is not obliged to take proceedings against the debtor before claiming from the surety.
86. Scotland - In the past the position was different in Scotland. There the subsidiary character of a cautionary obligation (suretyship) was recognised (provided it was constituted in the proper form) and the creditor was obliged to take proceedings against the debtor before he could claim against the surety. (This was known as the "benefit of discussion" or "beneficium ordinis"). This was altered by section 8 of the Mercantile Law Amendment (Scotland) Act 1856 and the position is now the same as in England (1).

#### A c c e s s o r y C h a r a c t e r

87. This has already been considered in Chapter 1(2). This applies to a suretyship and to a del credere agent but not to an indemnity. It is open to the parties to agree expressly that the "surety's" obligations will be greater than those of the debtor but if this is done the contract will be one of indemnity, not suretyship.

#### D i s c h a r g e o f t h e S u r e t y

88. There are various grounds on which the surety may be discharged. Many of them follow from, or are extensions of, the principle of the accessory nature of suretyship; others are based on the idea that the creditor should not be allowed to take action that unfairly prejudices the position of the surety. An indemnifier is in a less strong position and the question whether he will be discharged often depends on the exact terms of the contract.
89. The first general principle is that the surety will be discharged if the debtor is discharged : this follows from the accessory nature of suretyship. Obviously if the debtor performs his obligations, the surety is discharged; partial performance by the debtor will discharge the surety pro tanto. The extent to which these rules apply to an indemnity will depend on its terms.

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(1) It is possible, however, that section 8 of the Act of 1856 applies only where the caution is to guarantee a money debt. If the debtor's obligation is to perform an act it is possible that the old rule will still apply.

(2) See paras. 16 - 22.

90. If the creditor discharges the debtor by a binding legal agreement, this will also have the effect of discharging the surety unless the original contract of suretyship provided the contrary. The same applies where the creditor agrees to a novation (i.e. where a new obligation is substituted for the obligation undertaken by the debtor in the original agreement). The reason for this rule is that the surety would otherwise be prejudiced by losing his right to claim an indemnity from the debtor. It is not clear whether the same rule applies to an indemnity; it is probable that it does unless the contrary is stated in the contract.
91. Under section 28(4) of the Bankruptcy Act 1914 it is provided that an order of discharge will not release a person who was a surety or was "in the nature of a surety" for the bankrupt. Section 16(20) also provides that the same applies to compositions and schemes of arrangement entered into after the making of the receiving order.
92. If the creditor is guilty of a breach of contract against the debtor of such a nature that the debtor is discharged from his obligations under the contract, the surety will also be discharged. Likewise, the creditor cannot sue the surety if he is unable to sue the debtor because he (the creditor) has failed to carry out his part of the contract. If there is a breach of contract by the creditor which does not discharge the debtor but gives him a right to counterclaim for damages, the surety can also avail himself of this right by way of set-off if sued by the creditor; in fact the surety can avail himself of any defence that the debtor might have had which absolves him, partially or wholly, from the claims of the creditor. The extent to which these defences could apply to an indemnifier depends on the terms of the contract of indemnity.
93. The second general principle is that the surety will be discharged if the contract between the creditor and the debtor is varied. This is because a variation in the principal obligation will change the nature of the risk assumed by the surety. This rule only applies, however, if the variation could prejudice the surety : if there is no possibility of prejudice, there is obviously no reason why he should be discharged. This rule is, however, applied strictly : if there is any possibility of prejudice the surety will be discharged - even if in fact no prejudice occurs or if the variation in the contract is very slight. The surety will not, of course, be discharged if the contract of suretyship provided for such a variation.
94. A binding agreement by the creditor to give more time to the debtor will also discharge the surety : this is in fact an example of variation of the principal contract. (The surety is not discharged if the creditor in fact allows the debtor time to pay without entering into a legally enforceable obligation to do so). The argument for this rule is rather technical : it is said that the surety might wish to pay off the creditor as soon as the debt is due and then bring an action against the debtor. If the debtor is given an extension of time the surety would not be able to claim an indemnity from him until the new time limit has expired. It is not very likely in practice, however, that the surety would wish to do this; nevertheless the rule seems firmly established.

95. The creditor can protect his position in two ways : first, he can insert a clause into the original suretyship agreement allowing him to grant additional time; secondly, he can reserve his rights against the surety by informing the debtor, at the time when he grants additional time, that the position of the surety will not be affected (1). In either case the surety will not be discharged if additional time is granted. It should be noted that in the second case the consent of the surety is not required; however, if any variation is made to the principal agreement other than the granting of additional time, the consent of the surety must be obtained.
96. A third general principle is that the surety may be released if the creditor is guilty of conduct that prejudices the rights of the surety. It is, however, not always clear whether the surety will be completely discharged or whether he will be discharged only to the extent that he has in fact been prejudiced.
97. The first case is the release of a co-surety. This prejudices the rights of the remaining surety because he loses the right to obtain a contribution from the co-surety. It seems that if the co-sureties are jointly liable (or jointly and severally liable) the remaining surety (or sureties) will be totally released (2). This may not be so if they are severally liable.
98. The second case is where the creditor surrenders securities held by him. Here the matter seems to depend on whether the security was an essential part of the contract of suretyship : if it was, the surety will be fully discharged. If, however, it was not an essential part of the contract (e.g. if the debtor gave the security after the contract of suretyship was entered into) the surety will be discharged only to the extent that he was actually prejudiced. Again, it is possible for the contract of suretyship to give the creditor the right to release securities without discharging the surety.
99. The third case is where the creditor negligently fails to realise the value of a security (or fails to realise it to its full extent): in this case it seems that the surety is discharged only to the extent that he is in fact prejudiced.
100. Finally, it should be mentioned that the surety may be discharged if the creditor is guilty of a breach of the contract of suretyship. In this case the normal principles of the law of contract will be applied : if the breach goes to the root of the contract, or shows an intention to repudiate the contract, the surety will be completely discharged; otherwise the surety will be entitled to counterclaim for damages if sued by the creditor : this will mean in effect that he will be discharged only to the extent that he has actually been prejudiced.

NOTE : See further Chitty, pp. 787-98 and Goode, pp. 494-501.

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- (1) In this case the surety retains the right to pay the debt when it was originally due and claim an indemnity from the debtor.
  - (2) In Scotland this is expressly provided in section 9 of the Mercantile Law Amendment (Scotland) Act 1856 which makes an exception of the case when the discharged co-surety is bankrupt.

101. Scotland - The position in Scotland is basically the same : see Gow, pp. 317-26; Gloag and Henderson, pp. 227-32.

P r e s c r i p t i o n ( L i m i t a t i o n o f A c t i o n s )

102. It is important to distinguish between the prescription of the obligation of the surety and the prescription of the principal obligation. Once the surety's obligation is prescribed, no action can be brought against him. The period of limitation is laid down by the Limitation Act 1939, section 2, and is six years from the date on which the surety first became liable, i.e. the date on which he could first have been sued by the creditor. (This is normally when the debtor makes default but the contract of suretyship might lay down some condition precedent to his liability).
103. A more difficult problem arises where the principal obligation is prescribed but not that of the surety. It is not certain whether the surety can be sued in such a case (1). It would seem in accord with the accessory nature of suretyship to maintain that the surety could not be sued; though under English law prescription destroys merely the right of action, not the debt itself : the principal debtor is still under an obligation to perform but the creditor cannot enforce it. However, if the surety remained liable he would then be entitled to claim reimbursement from the debtor; the effect of this would be that the debtor would be made to pay indirectly.
104. Scotland - In Scotland there is a statute, the Cautioners Act 1695 (c.5), which is a statute of the Scottish Parliament (before the Union with England). This provides (in part) as follows :

"... no man binding and engaging for hereafter, for and with another conjunctly and severally, in any bond or contract for sums of money, shall be bound for the said sums for longer than seven years after the date of the bond, but that from and after the said seven years, the said cautioner shall be eo ipso free of his caution."

The exact meaning of this provision is not entirely clear but the following points should be noted. First, the Act does not apply to all cautionary obligations (contracts of suretyship) : it does not apply unless the principal obligation is a money debt and the cautionary obligation is created by the same instrument as the principal obligation. Secondly, the period of seven years starts to run from the date when the cautionary obligation is created not, as in England, from the date when the creditor can call upon the surety to make payment. The Act does not, however, apply if the principal obligation is not due within the seven year period (2).

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(1) See Rowlatt, p. 299.

(2) It may be that the principal obligation must be due throughout the seven year period : see Gloag and Henderson, p. 228; compare Gow, p. 318.

Thirdly, where the Act is applicable, it completely extinguishes the obligation so that if the surety pays in ignorance, he can reclaim what he paid. (In English law the Limitation Act merely takes away the remedy, it does not extinguish the obligation itself). See further : Gow, pp. 317-9; Gloag and Henderson, pp. 227-8.

#### S e t - O f f

105. The law concerning set-off is not entirely clear. If the debt to be set-off arose from the same transaction as that guaranteed, it is clear that the surety may benefit from any set-off available to the debtor; it is less certain, however, that he can do this if the debt arises from a completely different transaction (1).

#### P a r t n e r s h i p s

106. If a continuing guarantee is given either to a partnership or to a third person in respect of the transactions of a partnership, then the guarantee is automatically revoked as to future transactions, unless the contrary is stipulated in the contract of guarantee, if there is a change in the constitution of the firm in question. This is provided in the Partnership Act 1890, section 18 (2).  
Scotland - There is a similar provision in the Mercantile Law Amendment (Scotland) Act 1856, section 7.

#### C o s t s a n d I n t e r e s t

107. The question whether the surety is liable for the costs of legal proceedings taken by the creditor against the principal debtor or of interest on the debt depends on the terms of the contract of suretyship.

#### C o - S u r e t i e s

108. The question whether co-sureties are jointly, jointly and severally, or only severally liable (and in what proportion they are liable) depends on the terms of the contract of suretyship.

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- (1) According to Rowlatt (pp.137-41) the surety has no right to set off a debt due in a different transaction between the debtor and the creditor but if the creditor sues the surety for the whole amount, the debtor can demand that the set-off be made. The reason for this is that if the surety was obliged to pay the whole amount (without the benefit of the set-off), he could then claim reimbursement from the debtor. The effect of this would be that the debtor would lose the benefit of the set-off.
- (2) Applicable in Ireland but not Scotland.

## Chapter 5

### THE SURETY'S CLAIM FOR REPAYMENT

109. A surety who has paid the debt can claim against the debtor for repayment. There are, in fact, two different bases for this claim : the surety has a claim for indemnity and he is also subrogated to the creditor's rights against the debtor.

(NOTE : The term "indemnity" is used here in a wider sense (1) than normally used in this Report.)

#### The Surety's Right of Indemnity

110. The surety's right of indemnity is based on two possible legal foundations : an implied contract with the debtor or the law of restitution (quasi-contract). An implied contract can exist only if the suretyship was undertaken at the request (express or implied) of the debtor. If this is the case, however, the law assumes an implied agreement between them that the surety is to have right of indemnity against the debtor. Of course, the surety and debtor are free to enter into an express contract on this point and they may, if they wish, exclude such a right. If there is no implied contract between the debtor and the surety, the surety can claim a restitutionary remedy against the debtor on the ground that he has discharged a debt for which the debtor is ultimately liable.

111. It should be noted that the surety obtains this right to an indemnity only when he actually pays the debt; moreover, if he pays the debt before it was due, he cannot claim against the debtor until the due date. If the creditor sues the surety without suing the debtor, the surety can have the debtor made a party to the proceedings. The surety cannot obtain an indemnity from the debtor if he pays a debt which was not enforceable against the debtor (2); but it has been held that he can obtain an indemnity if he pays a debt that was not enforceable against him (the surety) because the contract of suretyship was not evidenced by a note or memorandum in writing as required by the Statute of Frauds (3).

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(1) See above, paras. 10-12. The term used in Scottish law is "relief". In Scotland, therefore, one talks of the cautioner's right to claim relief.

(2) See the Irish case of Coneys v. Morris (1922) 1 Ir.R.81. However, the case of Re Chetwynd's Estate (1938) Ch.13 is contrary to this.

(3) Alexander v. Vane (1836) 1 M & W 511. This is quite fair since the surety's payment relieved the debtor of a debt which was enforceable against him (the debtor).



112. Although the surety has no claim for payment against the debtor until he has first paid the creditor, he does have the right (at least where the suretyship was entered into at the request of the debtor) to bring action against the debtor to require him to pay the creditor and thus relieve the surety. This action can, of course, be brought only after the surety becomes liable to be sued by the creditor, i.e. when the debt is payable by the debtor.
113. The amount that the surety can claim against the debtor is the amount for which the surety was liable to the creditor (i.e. the amount for which the debtor was liable, unless the liability of the surety was limited to a lesser amount). The surety can probably also claim any reasonable costs he incurred in defending an action brought by the creditor provided he had a reasonable ground on which to defend it (1). It would probably be desirable, however, for the surety to have the debtor made a party to any proceedings brought by the creditor.
114. The position where the debtor is bankrupt is as follows. If the surety has paid the whole debt, he can claim for it against the debtor's estate; if he has not paid anything, he cannot claim at all and the creditor can claim for the whole debt (2). If the surety has paid only part of the debt, his right to claim depends on whether he guaranteed the whole debt (even if his liability was limited to a certain sum) or only part. If he guaranteed the whole debt and paid only part of it (even if his liability was limited to that amount), he cannot claim at all and the creditor may claim for the whole debt (3). If, on the other hand, the surety guaranteed only part of the debt, he can, once he has paid that part, claim against the debtor's estate for that part; the creditor can claim only for the unpaid part (4).
115. Where there is a contract of indemnity, not suretyship, it is not entirely clear whether the indemnifier has a right to an indemnity from the debtor once he has paid the creditor. It is likely that he would have such a right where the contract of indemnity was entered into at the request of the debtor and it is probable (depending on the terms of the agreement between the indemnifier and the debtor) that the indemnifier could recover in full what he was obliged to pay even if the debtor was not liable to the same extent. There is probably an exception to this, however, where the debtor is a minor. If the contract of indemnity is not entered into at the request of the debtor, the indemnifier could claim only restitutionary rights, or rights based on a subrogation of the creditor's rights, and he could not claim more than the debtor owed to the creditor.

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(1) See Rowlatt, pp. 195-6.

(2) If the creditor is not paid in full and obtains the balance of the debt from the surety, the latter cannot claim against the estate : to allow this would be to allow two claims for the same debt.

(3) If the creditor recovers more than the amount that remains owing, he must account to the surety for the difference. In Scotland, if the cautioner paid before the date of sequestration, the creditor cannot claim for more than the balance of the debt : Gow, p. 317; Gloag and Henderson, pp. 226-7.

(4) See further Chitty, para. 1678.

## S u b r o g a t i o n   a n d   A s s i g n m e n t

116. When the surety pays the creditor he is subrogated to the rights of the creditor against the debtor in respect of the debt in question. This is a question of equity. It is based on the idea that since the creditor has benefited from the payment of the debt by the surety it would be inequitable for him to retain or release any securities for the debt. This includes any securities held by the creditor which are charged with debt, including securities given by the debtor to the creditor after the contract of suretyship was entered into, even if the surety did not know of their existence. It should also be noted that if the creditor makes further advances to the debtor (for which the surety is not liable) and these further debts are charged to the same security, the claim of the surety, once he has paid the original loan, takes precedence over that of the creditor for the later advances (1).
117. In addition to the equitable right already mentioned, there is also a statutory right of assignment under section 5 of the Mercantile Law Amendment Act 1856. This provides that the surety is entitled to have assigned to him "every judgement, specialty or other security which shall be held by the creditor" in respect of the debt. This reinforces the equitable right already mentioned. The combined effect of these two principles is that the surety virtually stands in the shoes of the creditor when he claims against the debtor. Thus if the creditor was entitled to priority in respect of his debt in the event of the debtor's bankruptcy, the surety will be entitled to the same priority (2).
118. Scotland - The Mercantile Law Amendment Act does not apply to Scotland (and there is no provision equivalent to section 5 of it in the Mercantile Law Amendment (Scotland) Act. But under the common law of Scotland a cautioner (surety) who pays the debt is entitled to the assignation (assignment) of all the creditor's rights and securities against the debtor.

## R i g h t   o f   C o n t r i b u t i o n a g a i n s t   C o - S u r e t i e s

119. If there are two or more co-sureties and one of them pays more than his share, he is entitled to claim against the other (or others) for their shares (3). This principle is based on the law of restitution. It applies whether the co-sureties are joint, joint and several, or several. Where the sureties are joint (or

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(1) Forbes v. Jackson (1882) 19 Ch.D. 615. This may not be true in Scotland : see Gow, p. 316, citing Sligo v. Menzies (1840) 2 D. 1478 at 1491.

(2) For example, a surety who pays a Crown debt is entitled to the Crown's rights of priority : Re Lord Churchill (1888) 39 Ch.D.174.

(3) If proceedings for contribution are instituted against the co-sureties, the debtor should also be made a party (unless he is bankrupt or otherwise unable to pay). This is to allow the court to establish the right of all the sureties to be indemnified by the debtor. See Hay v. Carter (1935) 1 Ch. 397.

joint and several) each is, of course, liable to the creditor for the full amount but among themselves they are liable for equal shares unless they have agreed to a different division of liability. If the sureties are severally (separately) liable for only a portion of the debt, they cannot be made by the creditor to pay more than their share; but if one does pay the other surety's share, he can also claim a contribution. The right to a contribution arises whether the sureties are liable in the same contract or in different contracts; and it makes no difference that one co-surety was unaware of the existence of the other. The only requirement is that they should be sureties for the same debt. If one co-surety becomes bankrupt the position at common law was that the surety who paid the whole debt had to bear the loss : i.e. if there are three co-sureties and one of them pays the whole debt and one of the others goes bankrupt, the third surety is required to contribute only one third of the debt. At equity, however, the liability was divided among the solvent sureties so that the other solvent surety would have to contribute one half of the debt. The equitable position now prevails (1).

120. It is not clear whether there is a right of contribution in the case of an indemnity. There seems to be no reason why the same principles should not apply to co-indemnifiers; there would, however, be difficulties if sureties and indemnifiers were liable with regard to the same principal obligation : it is doubtful whether there could be a right of contribution between indemnifiers and sureties since the liability of the former might be greater than that of the latter (2).

NOTE : See further on the whole of this chapter.  
Chitty, paras. 1700-09;  
Gow, pp. 314-6;  
Gloag and Henderson, pp. 225-7.

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(1) This is also the position in Scotland.  
(2) See Chitty, para. 1705.

## Chapter 6

### PRIVATE INTERNATIONAL LAW

121. The private international law aspects of suretyship and indemnity are very uncertain in British and Irish law. Case law is sparse and ambiguous and the topic is ignored by most writers. The case of Rouquette v. Overmann (1) suggests that the law applicable to the suretyship must be the same as that applicable to the principal obligation. It is doubtful, however, whether this would be followed today and it is probable that a court would hold that the contract of suretyship is governed by its proper law (the law expressly or impliedly chosen by the parties or otherwise the law with the closest and most real connection with the contract) (2). This would not necessarily be the same as the proper law of the principal obligation but it is quite likely that the courts would hold that there is a presumption that the two contracts are governed by the same law.
122. The Statute of Frauds raises special problems. The effect of the Statute is not to render an oral contract void but merely to make it unenforceable. It was therefore decided in the case of Leroux v. Brown (3) that the statute should be classified as part of the law of evidence. This is regarded as being a matter of procedure and since there is a general rule that procedure is regulated by the law of the forum, the English Statute of Frauds will apply to all actions brought in an English court, even if the contract of suretyship on which the action is brought is governed, as to matters of substance, by the law of a foreign country. This decision means that if one Frenchman agreed in France with another Frenchman to act as surety for the debt of a third Frenchman, the English Statute of Frauds would have to be complied with if an action on the contract of suretyship were brought in an English court. This rule has been strongly criticised by English writers (4).

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(1) (1875) L.R. 10 Q.B. 525 at 537 (per Cockburn C.J.).

(2) See Powlatt, p. 64 and Martin Wolff, Private International Law (1950), p. 459.

(3) (1852) 12 C.B. 801 (= 138 E.R. 1119).

(4) See Dicey and Morris, The Conflict of Laws (8th ed. 1967), p. 735 n. 74 and p. 1098, n. 73. Leroux v. Brown has, however, been followed in other cases : Dicey and Morris, op. cit. p. 1098 n. 74.

## Chapter 7

### DIFFERENCES IN THE LAW

123. This chapter is concerned with those areas in which the law of the countries under study in this Report differs from the law of the other Member States. Only those differences that are significant from the point of view of this study will be considered.

#### T h e I n d e m n i t y (1)

124. Contracts of indemnity are fully recognised in the law of Britain and Ireland. They differ from a contract of suretyship in that the indemnifier undertakes an independent obligation, the scope of which is not limited to that of the debtor's obligation. This is advantageous to the creditor in those cases where the debtor might lack capacity to enter into the main contract and an indemnity would normally be used where the debtor is a minor. It should be noted that in Britain and Ireland (as in Germany) a contract of suretyship is void if the principal obligation is unenforceable as a result of the debtor's incapacity. It is perhaps of interest that in Germany, too, contracts of indemnity are recognised by the law.
125. The legal principles applying to indemnities are unfortunately not as well developed as those applying to suretyships and a great deal probably depends on the terms of the contract. Many principles of the law of suretyship will apply by analogy but one important provision that does not is the Statute of Frauds : there is no necessity for a contract of indemnity to be in writing (2). (The Scottish equivalent of the Statute of Frauds is section 6 of the Mercantile Law Amendment (Scotland) Act 1856; it is probable that this also does not apply to an indemnity).

#### C o n s i d e r a t i o n (3)

126. This doctrine is one of the special features of the English Common Law. It is part of the law in England and Ireland, but not in Scotland. In essence it requires that the creditor should do something (or refrain from doing something), or undertake some obligation, in exchange for the surety's entering into the contract of suretyship. It is probable that this rule will not cause many difficulties in practice where Community transactions are involved since in commercial transactions consideration normally exists anyway. It is probably unnecessary, therefore, to make any special provisions to deal with it.

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(1) See above, paras. 10-15.

(2) There is a limited exception under the Hire Purchase Act 1965 : see above, para. 68.

(3) Paras. 52-63.

### W r i t i n g (1)

127. In Britain and Ireland contracts of suretyship must be in writing. Similar rules are found in the laws of other Member States. However, there are differences of detail. First, in Britain and Ireland writing is an evidentiary, not a formal requirement : an oral contract of suretyship is not void, but merely unenforceable. If the surety nevertheless pays, he cannot recover the money paid. In private international law the English rule is classified as a rule relating to evidence (procedure). Since evidence is a matter for the lex fori, the English statute applies to all contracts of suretyship which are the subject of proceedings in English courts irrespective of the proper law of the contract.
128. Secondly, it should be noted that the contract itself need not be in writing, a note or memorandum in writing (which may be made after the contract is entered into) is sufficient. Thirdly, the document must be signed by the surety. Fourthly, it does not apply to a del credere agent's obligations or any other suretyship agreement that is part of a wider transaction. Finally, it should be noted that contracts of indemnity need not be in writing (except insofar as they come within the provisions of the Hire Purchase Act 1965) (2). Under the Consumer Credit Bill indemnities will have to be in writing.

### C o n s u m e r C r e d i t L e g i s l a t i o n (3)

129. There are various statutes designed to protect consumers from exploitation. In the U.K. these are to be replaced by the Consumer Credit Bill (which at the time of writing has not yet become law). The Bill requires suretyship and indemnity agreements to be in writing (if they come within its scope) and contains provisions concerning the form of documents and the right of the surety to be given copies of certain documents. It also provides that the creditor cannot obtain a greater benefit by claiming from a surety (or indemnifier) than he would get if the debtor fulfilled his obligations. This, of course, is a restatement of the principle that suretyship is an accessory obligation; but the Bill extends this principle to indemnities subject to one exception : where the debtor is a minor an indemnifier (but not a surety) is still liable as before. The Bill covers most consumer credit transactions where the sum in question is not over £5,000 and the debtor is not a corporation and will apply to a suretyship or indemnity if the principal obligation arises from a transaction within the scope of the Bill.

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(1) Paras. 64-70

(2) This applies only in England. For the other countries covered by this Study, see above, paras. 80a, b and c.

(3) Paras. 77-84.

N o n - S u b s i d i a r y C h a r a c t e r (1)

130. In Britain and Ireland the creditor is not obliged (in the absence of an agreement to the contrary) to take any legal proceedings against the debtor before claiming against the surety. It is probably only in rare cases that the parties would agree in the contract of suretyship that proceedings must first be taken against the debtor.

I n c a p a c i t y o f D e b t o r (2)

131. If the principal obligation is unenforceable against the debtor because he lacks capacity, the surety is not liable. This rule does not apply where the contract is one of indemnity, not suretyship.

S e t - O f f (3)

132. The English law of set-off is different from both the Roman Law and the German Law. In England set-off does not in itself extinguish a claim unless a court has given judgement to this effect. Set-off is not the fulfilment of an obligation, it is merely an excuse for non-performance. In other words it is a defence which may be raised by a debtor if he is sued for the debt. Of course, the parties may agree, in a situation in which a possibility of set-off exists, that the two debts will be cancelled. It should, however, be noted that a debtor is not obliged to plead set-off; if he wishes he can pay the debt he owes and then enforce that owing to him by action.
133. In the case of suretyship, if a situation of set-off exists between debtor and creditor, the surety can, if he is sued by the creditor, plead any set-off arising out of the same transaction as the secured claim that could have been pleaded by the debtor. It is uncertain whether he could plead a set-off arising out of a different transaction though if the debtor is a party to the proceedings (and the surety has the right to have him joined as a party), the debtor can plead such a set-off. It is unclear what would happen if the debtor refused to plead the set-off or if the creditor paid the debt owed by him and thus precluded the possibility of set-off.

E x t e n s i o n o f T i m e (4)

134. If the creditor allows the debtor further time in which to pay (or otherwise perform his obligation) the surety is discharged even if he suffers no prejudice. There are two exceptions to this : first, if the contract of suretyship gave the creditor

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(1) Paras. 85-6  
(2) Paras. 18-22.  
(3) Para. 105.  
(4) Paras. 94-5.

the right to grant an extension; secondly, if the creditor informs the debtor when he gives the extension that he is reserving his rights against the surety (where this is done the surety can pay the debt when it was originally due and demand immediate repayment from the debtor). This rule of British and Irish law has been strongly criticised and it is common practice to avoid it by inserting a special clause in the contract of suretyship to allow an extension of time (1). It would be desirable to abolish it to bring British and Irish law into line with that of other Member States.

#### P r e s c r i p t i o n (2)

135. There are some differences in the law relating to prescription : in England the period is six years from the date when the surety became liable; in Scotland, under the Cautioners Act of 1695, there is a period of seven years from the date of the contract of suretyship. However, since differences in the law relating to prescription in the other Member States were not regarded by the Max-Planck-Institut as being important enough to warrant a uniform rule (3), no more need be said on this topic.

#### T i m e L i m i t

136. If a surety agreed to enter into a continuing suretyship for a given period, this would normally be interpreted in Britain and Ireland as meaning that he will guarantee all debts contracted by the debtor during that period (4); it would not oblige the creditor to assert his claims against the surety during the period in question. If, however, there was a specific agreement to this effect, it would be strictly enforced by the courts : no period of grace would be allowed.

#### I n d e t e r m i n a t e S u r e t y (5)

137. The question whether the surety can revoke an indeterminate continuing surety depends on the terms of the contract of suretyship and the nature of the consideration. If the surety effectively binds himself to enter into such a suretyship it is doubtful whether he can revoke it. (In normal banking practice, there is usually a clause in the contract allowing the surety to revoke it on giving notice of, say, three months) (6). The right

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(1) See Holden, pp. 313-4.

(2) Paras. 102-4.

(3) Para. 148.

(4) It is a common clause in a contract for a continuing suretyship that the surety may revoke his obligation on giving the creditor a certain period of notice (e.g. three months). For the effect of such a clause (including the question whether further advances can be made to the debtor after notice has been given but before it has expired) see Holden, pp. 227-8.

(5) Paras. 73-6

(6) Holden, loc. cit.



of denunciation found in German and Netherlands law has no counterpart in Britain and Ireland.

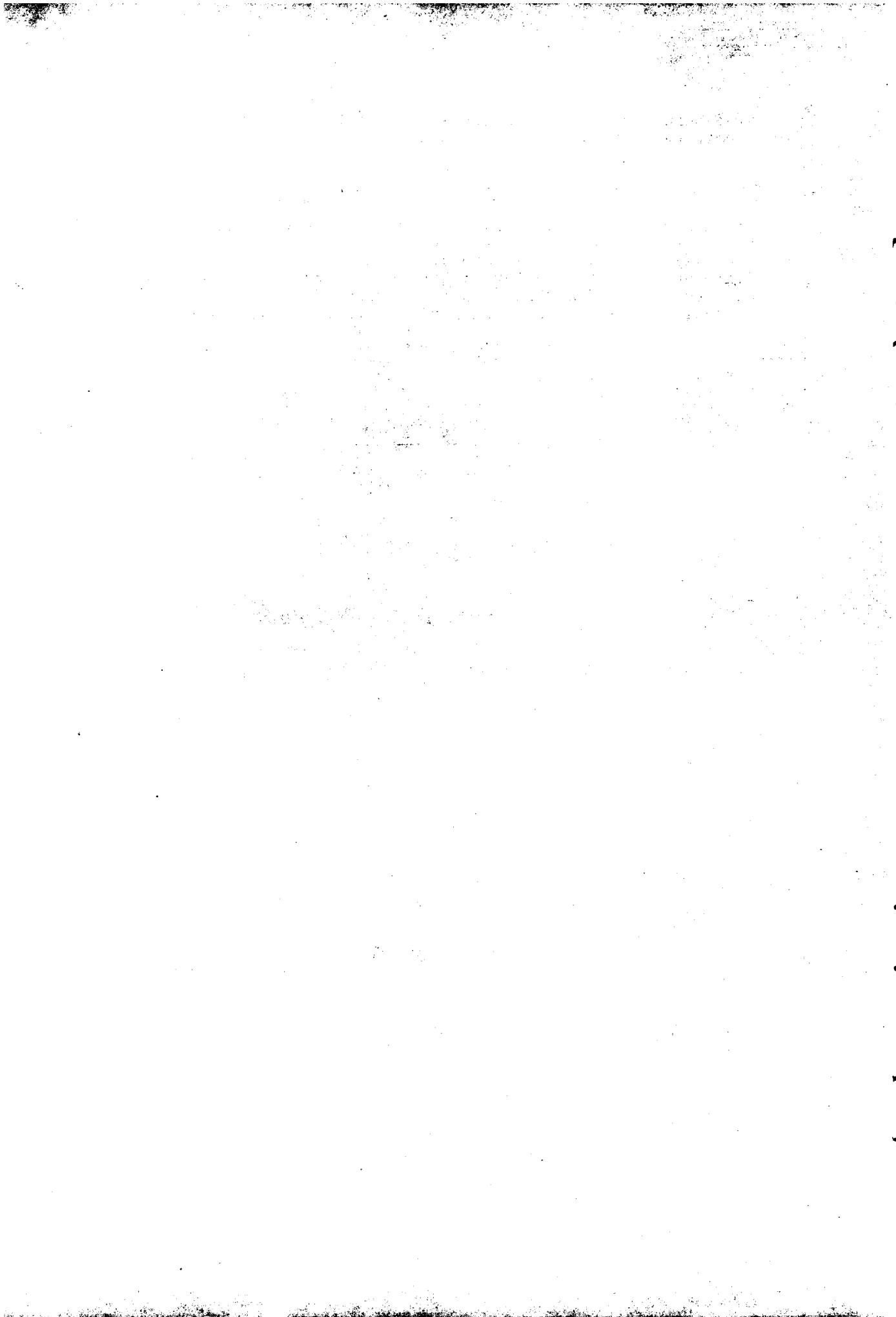
B a n k r u p t c y   o f   D e b t o r (1)

138. The differences in the law in this area are concerned mainly with the question whether a surety who has paid only part of the debt can claim against the estate of a bankrupt debtor. There are also differences on this point in the law of the six Member States covered in the Max-Planck-Institut Report (2). However, there is probably no need to have any uniform rule on the matter.

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(1) Paras. 114-5.

(2) Paras. 155, 156.



Part II

RECOMMENDATIONS

Chapter 8

COMMENTS ON DRAFT DIRECTIVE

(These comments are based on the English version of the provisional draft of articles 1 to 11 as agreed on 28 September 1973 (XI/494/73-E)).

F i e l d o f A p p l i c a t i o n

139. Scottish Law - A general problem of terminology arises in the English language version of the Directive with regard to Scottish terminology. As will be clear from this Report, the Scottish law on this subject is, with regard to most questions, the same as the English and Irish law. However, the terminology is often different. Thus the normal Scottish term for "suretyship" is "cautionary obligation" and for "surety" is "cautioner". The English terminology is often used in Scotland but it might be thought desirable to include the Scottish terminology as an alternative in the English version of the directive : e.g.

(a) suretyship (cautionary obligation),

I suggest that wherever the terms "surety" or "suretyship" are used the Scottish equivalents be added in brackets.

140. Paragraph 1(b) : As explained previously, in England and Ireland the term "guarantee" normally means exactly the same as "suretyship". The term "indemnity" should therefore be used in the English language version.
141. Paragraph 1(d) : There is no equivalent in British or Irish law to this concept of German and Italian law. (See above, paras. 41-2).
142. Paragraph 2(a) : In English and Irish law there is a distinction between "joint liability" and "joint and several liability" (1). In Scotland the appropriate term is "liability in solidum" (2). It would be desirable for this paragraph to read, in its English version :
- (a) mere joint, or joint and several liability  
(liability in solidum).

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(1) See above, paras. 23-5.

(2) See above paras. 30-4.

## A r t i c l e 1

143. There is, of course, no difficulty in declaring that Member States must not discriminate against nationals of other member States (or persons resident in other Member States). If, however, it is desired to prevent private persons from discriminating on this ground, it might be rather difficult to enforce the Directive in practice since creditors normally reserve the right to reject any proposed surety without having to give reasons.

## A r t i c l e 2

144. This article would bring about certain changes in British and Irish law. To explain these clearly it is desirable to summarise briefly the present position (1). In British and Irish law the requirement of writing is based purely on statute. There are two groups of statutes :
1. The Statute of Frauds and its equivalents : These are the Statute of Frauds 1677, section 4 (applicable in England); the Statute of Frauds (Ireland) 1695, section 2 (applicable in Northern Ireland and in the Republic of Ireland) and the Mercantile Law Amendment (Scotland) Act 1856, section 6 (applicable in Scotland). All these are of similar effect and will be referred to simply as "the Statute of Frauds".
145. The Statute of Frauds does not apply to a suretyship agreement which is an incident in a wider transaction and for this reason does not apply to the obligation undertaken by a del credere agent. It also does not apply to a contract of indemnity.
146.       2. Other legislation. Certain other statutes of limited scope also require writing. At the present time the relevant statute in England is the Hire-Purchase Act 1965 (2). In the U.K. these provisions will be soon replaced by the Consumer Credit Bill (not yet enacted) (3). These provisions apply only if the principal obligation guaranteed by the suretyship comes within the scope of the Act in question.
147. The following points should be noted about the Statute of Frauds (4) :
1. The contract itself need not be in writing provided there is a note or memorandum in writing setting out the terms of the contract. This may be made after the contract has been entered into. Under the draft Directive the contract itself will have to be in writing.

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(1) See above paras. 64-70.

(2) See above, paras. 77-80.

(3) See above, paras. 81-4.

(4) See above, paras. 64-70.

2. Under the Statute of Frauds the person bound, i.e. the person against whom the contract is enforced (usually the surety) must sign it personally or someone duly authorised by him must sign it. This is not specifically dealt with in the draft Directive. It is suggested in the Max-Planck-Institut Report (comment 3, p. 175) that the concept of written form is uniformly construed to include signature of the document. It is not certain that this is the case in English law.  
Another point that is not clear in the draft Directive is whether both parties must sign it or only the party against whom it is enforced. Presumably under the draft Directive signature by an agent would be sufficient if the agent was authorised to sign.
3. The exceptions to the Statute of Frauds (indemnities, del credere agents, suretyships which are an incident of a wider transaction) would no longer apply under the draft Directive. This would probably be desirable. The fact that a contract of indemnity - a more onerous transaction than a contract of suretyship - need not be in writing has long been a subject of criticism.
4. The Statute of Frauds is evidentiary, not a condition precedent to validity.
5. Part performance by the surety probably does not make the contract enforceable but it is probable that money paid by a surety under an oral contract cannot be recovered by him from the creditor (1)

148. The following points should be made about the draft Directive :

1. When the draft Directive comes into force the Statute of Frauds would probably be repealed. There should be no difficulty about this. However, there would be great difficulties in the way of altering the provisions of clause 100 of the Consumer Credit Bill (which provides for regulations to be made to prescribe the form and content of a document creating a security if the principal obligation comes within the scope of the Bill). The purpose of these regulations is to make it clear to the surety exactly what his rights and obligations are, i.e. to prevent onerous clauses being put in very small print and hidden in an obscure part of the document. It would obviously be undesirable to lessen the protection given by these provisions and it is likely that they would have to apply in addition to the general provisions of the draft Directive. It should, however, be stressed that the Consumer Credit Bill will apply only to certain suretyships. (See Part II of the Bill).
2. The third sentence of paragraph 1 is not entirely clear. According to the Max-Planck-Institut Report (2) the purpose of this provision is to prevent the surety having the right to reclaim money paid under an oral contract. This is

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(1) See above, para. 66.  
(2) Comment 4, pp. 175-6.

probably already the law in England (1). The problem, however, is what happens if the surety pays only part of the debt. Clearly under the draft Directive he would not be able to reclaim what he has already paid, but would the creditor then be able to enforce the obligation as to the rest of the debt? This is probably not the law in England (though there would be no difficulty in introducing such a rule if this were thought desirable). Clarification on this point is needed.

3. Paragraph 2 would probably not be applicable to Britain and Ireland since the Statute of Frauds is not a condition precedent to validity. It should also be mentioned that in Britain and Ireland there is no separate commercial code and no general concept of a merchant or trader. There would consequently be difficulties in introducing special provisions for merchants (traders).

### Article 3

#### First Sentence

149. This accords with present British and Irish law. Of course, the parties can agree either that the surety shall be under a greater liability than the principal debtor (in which case the contract is not one of suretyship but one of indemnity) or that the surety shall be under a lesser liability (for example by limiting his liability to a specified sum).

#### Second Sentence

150. This is also in accord with the present British and Irish law. Again, the parties may agree otherwise in the contract of suretyship.

### Article 4

#### Paragraph 1

151. It has already been mentioned that the theory of set-off in English law is different from that in both the Roman Law countries and in Germany (2).
152. In British and Irish law a surety can benefit from a set-off available to the debtor against the creditor if the debt to be set off arises out of the same transaction as the secured claim. It is doubtful, however, whether he can claim a set-off arising out of a different transaction.

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(1) See above, para. 66.

(2) See above, paras. 132-3.

153. The debtor can, of course, claim such a set-off if he is sued by the creditor. If, therefore, the surety is sued by the creditor, he can have the debtor made a party to the proceedings and the debtor can then claim the set-off. If, however, the debtor refuses to claim the set-off, it is doubtful whether the surety can claim it (1).
154. It is unclear what the position in British and Irish law is where the creditor pays a debt due by him that might have been set-off against the secured claim.
155. The Commission should consider whether the surety should be given the right to benefit from a set-off available to the debtor which arises out of a different transaction.
156. Scotland - The Scottish term for "set-off" is "compensation".  
NOTE : For a discussion of the general principles of set-off in English law (not in relation to suretyship) see Odgers on Pleading and Practice (20th ed. 1971), chap. 14.

#### Paragraph 2

157. Sub-paragraph (a) : "his own debt". This should read "the debt owed to him". (As it stands it is ambiguous and would probably be read to mean "the debt owed by him").
158. Sub-paragraph (b) : it is unclear what would constitute "proper grounds". It has already been stated that in British and Irish law set-off only arises where an action is brought; even in this case the defendant cannot be obliged to plead set-off : in other words he always has the right not to claim it.
159. It should finally be said that this whole Article is based on the concept of set-off which exists in the law of the Continental Member States and it does not fit easily into the structure of British and Irish law.

#### Article 5

160. The purpose of this Article is unclear. Is it intended to be a rule of interpretation to be applied only when the intention of the parties as expressed in the contract is unclear; or is it intended to apply even if the parties expressly agreed to something different?
161. There are three separate things that the parties may agree upon :
1. They may agree that the surety will be liable only for debts contracted during the period in question.
  2. They may agree that the surety will be liable only for debts due for payment during this period.

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(1) See above, para. 105.

3. They may agree that the liability of the surety will terminate unless legal proceedings have been begun against him before the end of the period.

In the first two cases the surety may be sued after the period has expired (subject to the law of prescription) : the parties are concerned only with establishing for which debt he is liable.

162. If the Article is intended to do more than establish a rule of interpretation, it would apply only where it is unclear from the contract which of these three possibilities the parties agreed upon. As the Article is now drafted, however, it might be regarded as having the effect of transforming an agreement of type 1 or 3 into one of type 2 (notwithstanding the fact that Article 5 is not mandatory). If it is intended to do no more than lay down a rule of interpretation, the Article should be re-drafted to make this clear.

## Article 6

### Paragraph 1

163. It might be better from a stylistic point of view for the word "Except" to replace the word "Subject". It would also be desirable to state expressly that the termination will not be effective until the creditor has been informed (or that the way in which the termination is to be effected is by the surety informing the creditor).

### Paragraph 3

164. There are a number of ways in which this paragraph is unclear. May the parties agree that a fixed period of notice must be given? (It might be better to say "... that notice must be given before the termination takes effect."). May they agree that the right to terminate shall not be exercised during a fixed period (provided that the period is reasonable)?
165. According to Article 10, this Article is mandatory. However, since Article 6 does not apply to a suretyship entered into for a fixed period, the parties could circumvent its provisions by agreeing that the suretyship shall continue for a very long fixed period (e.g. 99 years). It should be noted that English law does not recognise any general principle of abuse of rights or evasion of the law; consequently even if it were quite clear that the purpose of stipulating such a long term was to deprive the surety of the right to terminate, the agreement would still be quite valid (1).

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(1) In Scotland the suretyship cannot normally last for more than 7 years; see above para. 104.



## Article 7

### Paragraph 1

166. The phrase "deteriorated substantially" is very vague. Presumably it is something less than bankruptcy but it would not be easy for an English court to apply this provision as it is now drafted. It would again be desirable to state that termination is to be effected by informing the creditor.

### Paragraph 3

167. See the suggested reformulation of para. 3 of Article 6.

There seems to be no reason why Article 7 should be mandatory (see Article 10). If the parties wish to state expressly that the suretyship is to continue notwithstanding a deterioration in the debtor's financial position, what objection can be taken to holding the surety to his agreement?

## Article 8

168. Generally speaking in England the successful party in civil litigation is entitled to costs. This means that the unsuccessful party is obliged to pay the court fees, lawyer's fees and other expenses incurred by the successful party. Not all the expenses incurred are, however, included and there are rules as to what items of expenditure may be included and how much may be charged by lawyers for doing various things. In case of dispute there is a special procedure for assessing the costs which takes place before a court official. It should also be noted that the successful party is not automatically entitled to costs : he must ask the court to award costs and, if the court does this, the order for costs is part of the judgement. Costs normally are awarded to the successful party unless he is guilty of some misconduct.
169. In view of this, the second alternative of Article 8 would have a much more precise meaning in England than the first alternative and would be preferable for this reason.
170. It should be mentioned that, unless the creditor is obliged under the contract of suretyship to sue the debtor before claiming against the surety, it would be desirable for the creditor to sue both debtor and surety jointly : in this way the costs of two legal actions would be avoided. It could be argued that if the creditor fails, without good reason, to do this, he should not be entitled to recover the costs of both proceedings from the surety.
171. Finally a drafting point : the phrase "after the liability of the surety had expired" appears to imply that the surety is no longer liable for the original debt. What presumably is meant is that, if under the contract of suretyship the surety is liable only for debts contracted (or payable) during a certain period of time, the fact that this period has expired does not prevent the surety being liable for costs incurred in connection with legal proceedings instituted against the debtor to recover a debt for

which the surety is liable. I suggest that this be re-drafted so that its meaning is clear.

#### A r t i c l e 9

172. Contracts of indemnity are recognised in British and Irish law (except as mentioned below) and it is, therefore, desirable that the draft Directive should confirm their validity.
173. As already mentioned, the term "indemnity" alone should be used in the English language version (1).
174. The Article does not contain a definition of an indemnity. Might this not be desirable in view of the fact that this term might not mean the same thing in all Member States (2)?
175. As a general rule in British and Irish law there is no objection if the indemnifier wishes to undertake an obligation, the validity and extent of which are not dependent on the debtor's obligation. There are however, certain exceptions to this. First, if the principal contract is illegal or contrary to public policy (e.g. a contract to commit a criminal offence) it is probable that the indemnity would be invalid as well. Secondly, it is provided under clause 102 of the Consumer Credit Bill (not yet law) that where a security is given in relation to a principal obligation that is regulated by the Bill, the security cannot be enforced to allow the creditor to obtain a greater benefit than he would obtain if the debtor under the principal obligation carried out his obligations to the extent to which they would be enforced under the Bill. There is one exception to this under sub-clause (6) which concerns the case where the debtor is a minor (3).
176. It would be desirable for Article 9 to be drafted in such a way as not to affect either the rule concerning illegal contracts or the provisions of the Consumer Protection Bill.
177. Finally there seems to be a mistake in the third line of paragraph one (English version). Should it not be "the debtor's obligation" instead of "the indemnifier's obligation"?

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(1) See above paras. 4 and 5

(2) The following is a suggested definition : a contract of indemnity is a contract (not being a contract of insurance) in which one person (the indemnifier) agrees with another (the beneficiary) that he will make good any financial loss suffered by the beneficiary as a result of his entering or having entered into a contract or purported contract with a third party (the debtor). Such loss may result either from the fact that the contract or purported contract was wholly or partly invalid or unenforceable or from the fact that the debtor failed to carry out his obligations under it.

(3) See above para. 82-83.

Article 11

178. Paragraphs 1 and 2 present no difficulty.
179. It might be desirable for the question of formalities to be dealt with expressly. Whether this is a problem will depend on the final form of Article 2. If one uniform rule is laid down for the whole Community no question of conflict of laws within the Community could arise. If however, certain questions are left to national legislation, conflict of laws problems could arise.
180. It should be remembered that in England the Statute of Frauds is classified as being a procedural requirement (1). It would be desirable to provide, therefore, that all provisions concerning writing should be classified, for the purposes of private international law, as formal requirements (even if they are regarded as matters of evidence for the other purposes). For example : if it were eventually decided that the question whether a contract by telex satisfies the requirements of Article 2 is to be decided by national legislation, it would be undesirable if the national legislation of the forum were applied instead of the law applicable under Article 11. If an English court classified the new requirement laid down by Article 2 in the same way as the Statute of Frauds it would mean that the English rule would be applied to all proceedings brought in an English court. I therefore suggest a provision as follows :
- "Any provision of the law of any country requiring that a contract of suretyship (or a note or memorandum thereof) is to be in writing or prescribing the form of the document embodying such a contract is to be classified for the purposes of private international law (but not necessarily otherwise) as being a requirement of form."
181. The Commission might like to consider whether there should be a specific provision to the effect that a contract of suretyship is to be valid as to form if it complies with either the system of law governing the contract under Article 11 or the law of the place where the contract is made. This rule is probably part of the law of all the Member States (2) and it may therefore be unnecessary to deal with it expressly.
182. If such a rule were introduced it would be desirable to define what the locus contractus is in those cases where the parties are not in the same place when a contract is concluded. The rule in English law is that when a contract is concluded by a non-instantaneous form of communication, e.g. by post, the locus contractus is the place where the offeror posts his letter of acceptance. If an instantaneous form of communication such as telephone or telex is used, the locus contractus is the place where the offeror receives the acceptance (3).

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(1) See above, para. 122.

(2) For England, see Dicey and Morris, The Conflict of Laws (8th ed. 1967), pp. 749-54.

(3) See Dicey and Morris, *op. cit.*, p. 193.

183. I assume that the rules for defining the locus contractus may be different in other Member States. If it is thought desirable to have a uniform rule, there are various possible solutions to this problem that could be adopted. A general question of policy that would have to be decided is whether the rule should be designed to validate transactions wherever possible or to protect the surety.
184. Another question is the scope of the law laid down by Article 11. Would it, for example, govern the right of a surety who has paid the debt to be indemnified by the debtor? If the right of indemnification arises from a contract between the surety and the debtor, it could be argued that the law governing that contract should decide the matter. If there is no such contract, it might be argued that the law governing the restitutionary claim (quasi-contractual obligation, unjust enrichment) should govern. It would be unfortunate if this were a different law from that governing the surety's liability to the creditor since a surety who was liable to the creditor under that law might find that he had no right to indemnification under the law governing the restitutionary claim.
185. Presumably the law governing the suretyship would decide whether a surety who pays the debt is subrogated to the rights of the creditor; but what law decides whether the surety is entitled to a contribution from a co-surety? One assumes that this is also decided by the law governing the suretyship but what if the two sureties entered into separate contracts of suretyship which are governed by different systems of law?

#### P r o p o s e d   N e w   A r t i c l e

186. It has already been mentioned that in British and Irish law an extension of time given to the debtor by the creditor normally has the effect of releasing the surety (1). I propose that this rule be changed so as to bring British and Irish law into line with that of the other Member States. The new Article should apply only in the absence of an express agreement on the point in the contract of suretyship. It should also provide that, if an extension of time is given to the debtor, the surety shall have the right either to require the debtor to pay the debt at the date when it was originally due or to pay the debt himself when it was originally due and claim indemnification from the debtor.

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(1) See above, paras. 94-5 and 134.

### Part III

#### APPENDICES

##### Appendix I

###### - BIBLIOGRAPHY -

The following are cited by the name of the author alone :

- Charlesworth's Mercantile Law (11th ed. 1967 by C.M. Schmitthoff and D.A.G. Sarre). A basic general work with a chapter on suretyships.
- Chitty on Contracts; vol. 11 : Specific Contracts (23rd ed. 1968). Chap. 13 deals with suretyship and indemnity. This is probably the best work on the subject.
- W.M. Gloag and R.C. Henderson, Introduction to the Law of Scotland (7th ed. 1968). A standard general work on Scottish law. Chap. 19 deals with suretyship.
- R.M. Goode, Hire-Purchase Law and Practice (2nd ed. 1970). Chap. 22 deals with suretyship and indemnity. The book is primarily concerned with guarantees and indemnities in relation to hire-purchase but there is a great deal of useful general information.
- J.J. Gow, The Mercantile and Industrial Law of Scotland (1964). Chap. 5 deals with suretyships in Scottish law.
- Hals. = Halsbury's Law of England (3rd ed. 1957) Vol. 18. This is an encyclopaedia of English law. Suretyship is dealt with in Vol. 18.
- J.M. Holden, The Law and Practice of Banking : Vol. 11 Securities for Bankers'Advances (5th ed. 1971) Part V deals with suretyship.
- Sir Sidney Rowlatt, The Law of Principal and Surety (3rd ed. 1936 by A.A. Mocatta). This book is not very satisfactory but it is the only full-length study on the subject published in England.

##### C o m m u n i t y   S t u d i e s

The following abbreviations have been used in citing Community studies :

"Max-Planck-Institut Study" = Max-Planck-Institut für ausländisches und internationales Privatrecht, The Suretyship in the Law of the Member States of the European Communities (1969).

"My Report on Property" = Trevor C. Hartley, Study on the internal law of the United Kingdom of Great Britain and Northern Ireland in the field of property law (1972).

## Appendix II

### STATUTES

Confusion can be caused by the number of parliaments involved. In this Appendix the parliament which passed a particular statute will be indicated by the following abbreviations inserted after the date of the statute :

- U.K. = The United Kingdom Parliament. For the sake of convenience this abbreviation will cover the following :
- i. English Parliament (up to 1707);
  - ii. Parliament of the United Kingdom of Great Britain (i.e. England and Scotland) (1707 - 1801);
  - iii. Parliament of the United Kingdom of Great Britain and Ireland (i.e. England, Scotland and the whole of Ireland) (1801 - 1922);
  - iv. Parliament of the United Kingdom of Great Britain and Northern Ireland (1922 to the present day).
- Scot. = Scottish Parliament (up to the Union with England in 1707).
- Irl. = The Irish Parliament (covering the whole of Ireland; abolished in 1801).
- N.I. = The Parliament of Northern Ireland (established in 1922; suspended in 1972).
- R.I. = The Parliament of the Republic of Ireland (known as the "Dail"; established in 1922).

It is important to note that the statutes of the U.K. Parliament may apply only to England, only to Scotland or to the whole of the U.K. Statutes passed before 1922 may also apply to the Republic of Ireland.

### A. TABLE OF STATUTES

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#### B.TEXTS OF SELECTED STATUTES

##### The Statute of Frauds 1877 (U.K.)

This applies only in England; but identical provisions apply to both parts of Ireland by virtue of Section 2 of the Statute of Frauds (Ireland) Act 1695 (Irl.); a similar (but not identical) provision applies to Scotland by virtue of section 6 of the Mercantile Law Amendment (Scotland) Act 1856 (U.K.) (below).

"4. ... 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 Mercantile Law Amendment Act 1856 (U.K.)

This applies to England and both parts of Ireland; it does not apply to Scotland.

"3. No special promise to be made by any person ... to answer for the debt, default, or miscarriage of another person, being in writing and signed by the party to be charged herewith, or some other person by him thereunto lawfully authorised, shall be deemed invalid to support an action, suit, or other proceeding to charge the person by whom such promise shall have been made, by reason only that the consideration for such promise does not appear in writing, or by necessary inference from a written document."

"5. Every person who, being surety for the debt or duty of another, or being liable with another for any debt or duty, shall pay such debt or perform such duty, shall be entitled to have assigned to him, or to a trustee for him, every judgement, specialty, or other security which shall be held by the creditor in respect of such debt or duty, whether such judgement, specialty or other security shall or shall not be deemed at law to have been satisfied by the payment of the debt or performance of the duty, and such person shall be entitled to stand in the place of the creditor, and to use all the remedies, and, if need be, and upon a proper indemnity, to use the name of the creditor, in any action or other proceeding, at law or in equity, in order to obtain from the principal debtor, or any co-surety, co-contractor, or co-debtor, as the case may be, indemnification for the advances made and loss sustained by the person who shall have so paid such debt or performed such duty, and such payment or performance so made by such surety shall not be pleadable in bar of any such action or other proceeding by him : Provided always, that no co-surety, co-contractor, or co-debtor shall be entitled to recover from any other co-surety, co-contractor or co-debtor, by the means aforesaid, more than the just proportion to which, as between those parties themselves, such last-mentioned person shall be justly liable."

T h e M e r c a n t i l e L a w

A m e n d m e n t ( S c o t l a n d ) A c t 1 8 5 6 ( U . K . )

This Act applies only in Scotland.

"VI. From and after the passing of this Act, all Guarantees, Securities, or Cautionary Obligations made or granted by any Person for any other Person, and all Representations and Assurances as to the Character, Conduct, Credit, Ability, Trade, or Dealings of any Person, made or granted to the Effect or for the Purpose of enabling such Person to obtain Credit, Money, Goods, or Postponement of Payment of Debt, or of any other Obligation demandable from him, shall be in writing, and shall be subscribed by the Person undertaking such Guarantee, Security, or Cautionary Obligation, or making such Representations and Assurances, or by some Person duly authorised by him or them, otherwise the same shall have no Effect."

"VII. No Guarantee, Security, Cautionary Obligation, Representation, or Assurance granted or made after the passing of this Act to or for a Company or Firm consisting of Two or more Persons, or to or for a single Person trading under the Name of a Firm, shall be binding on the Granter or Maker of the same in respect of anything done or omitted to be done, after a Change shall have taken place in any One or more of the Partners of the Company or Firm to which the same has been granted or made, or of the Company or Firm for which the same has been granted or made : Unless the Intention of the Parties that such Guarantee, Security, Cautionary Obligation, Representation, or Assurance, shall



continue to be binding, notwithstanding such Change, shall appear either by express Stipulation, or by necessary Implication from the Nature of the Firm or otherwise."

"VIII. Where any Person shall, after the passing of this Act, become bound as Cautioner for any Principal Debtor, it shall not be necessary for the Creditor to whom such Cautionary Obligation shall be granted, before calling on the Cautioner for Payment of the Debt to which such Cautionary Obligation refers, to discuss or do Diligence against the Principal Debtor, as now required by Law; but it shall be competent to such Creditor to proceed against the Principal Debtor and the said Cautioner, or against either of them, and to use all Action or Diligence against both or either of them which is competent according to the Law of Scotland : Provided always, that nothing herein contained shall prevent any Cautioner from stipulating in the Instrument of Caution that the Creditor shall be bound before proceeding against him to discuss and do Diligence against the Principal Debtor."

"IX. From and after the passing of this Act, where Two or more Parties shall become bound as Cautioners for any Debtor, any Discharge granted by the Creditor in such Debt or Obligation to any One of such Cautioners without the Consent of the other Cautioners shall be deemed and taken to be a Discharge granted to all the Cautioners; but nothing herein contained shall be deemed to extend to the Case of a Cautioner consenting to the Discharge of a Co-cautioner who may have become bankrupt.

The Hire - Purchase Act 1965 (U . K .)

This Act applies only in England. Similar provisions apply in Scotland by virtue of the Hire-Purchase (Scotland) Act 1965 (U.K.); and in Northern Ireland by virtue of the Hire-Purchase Act 1966 (N.I.). All these Acts will be repealed (except for a small part of the N.I. Act) by the Consumer Credit Bill, if it becomes law. The law in the Republic of Ireland is somewhat different : see the Hire-Purchase Acts 1946 and 1960 (R.I.).

"14. (I) Where a notice of cancellation operates so as to rescind a hire-purchase agreement, a credit-sale agreement or a conditional sale agreement :

- (a) that agreement, and any contract of guarantee relating thereto, shall be deemed never to have had effect, and
- (b) any security given by the prospective hirer or buyer in respect of money payable under the agreement, or given by a guarantor in respect of money payable under such a contract of guarantee, shall be deemed never to have been enforceable."

"22. (I) A contract of guarantee relating to a hire-purchase agreement, a credit-sale agreement or a conditional sale agreement, and any security given by a guarantor in respect of money payable under such a contract, shall (subject to the following provisions of this section) not be enforceable unless, within seven days of the making of the contract of guarantee or the making of the hire-purchase agreement, credit-sale agreement or conditional sale agreement, whichever is the later, there is delivered or sent to the guarantor :

- (a) a copy of the hire-purchase agreement, credit-sale agreement or conditional sale agreement, and

- (b) a copy of a note or memorandum of the contract of guarantee, being a note or memorandum signed by the guarantor or by a person authorised by him to sign it on his behalf.
- (2) Subject to the next following subsection, such a contract of guarantee, and any such security, shall also not be enforceable unless:
  - (a) each copy delivered or sent as mentioned in the preceding subsection, and
  - (b) the note or memorandum of the contract of guarantee, complies with the requirements of any regulations made under section 32 of this Act, in so far as any such requirements relate thereto.
- (3) If in any action the court is satisfied that a failure to comply with any requirement imposed by subsection (1) of this section, or with any such requirement as is mentioned in the last preceding subsection, has not prejudiced the guarantor, and that it would be just and equitable to dispense with that requirement, the court may, subject to any conditions that it thinks fit to impose, dispense with that requirement for the purpose of the action."

"23. (1) Where a contract of guarantee relating to a hire-purchase agreement, a credit-sale agreement or a conditional sale agreement is for the time being in force, and the final payment under that agreement has not been made, any person entitled to enforce the contract of guarantee against the guarantor shall, within four days after he has received a request in writing from the guarantor, and the guarantor has tendered to him the sum of 2s.6d. for expenses, supply to the guarantor the documents specified in the next following subsection.

- (2) The documents referred to in the preceding subsection are :
  - (a) a copy of the hire-purchase agreement, credit-sale agreement or conditional sale agreement, or, in the case of a credit-sale agreement under which the total purchase price does not exceed £30, a copy of any note or memorandum of the agreement; and
  - (b) a copy of a note or memorandum of the contract of guarantee; and
  - (c) a statement signed by, or by the agent of, the person to whom the request in writing referred to in the preceding subsection is made, showing the matters specified in paragraphs (a) to (c) of section 21 (1) of this Act.
- (3) In the event of a failure without reasonable cause to comply with subsection (1) of this section, then, while the default continues, :
  - (a) no person shall be entitled to enforce the contract of guarantee against the guarantor, and
  - (b) no security given by the guarantor in respect of money payable under that contract shall be enforceable against the guarantor by any holder of that security,

and, if the default continues for a period of one month, the person in default shall be liable on summary conviction to a fine not exceeding £25.

(4) If a copy supplied to a guarantor in pursuance of a request made by him under this section does not comply with such requirements of any regulations made under section 32 of this Act as relate thereto, the last preceding sub-section shall apply as if that copy had not been supplied to him.

(5) Section 2 (4) of this Act applies to this section."

"34. (I) The owner (where the agreement is a hire-purchase agreement) or the seller (where it is a conditional sale agreement) shall not enforce any right to recover possession of the protected goods from the hirer or buyer otherwise than by action.

(2) If the owner or seller recovers possession of protected goods in contravention of the preceding subsection, the agreement, if not previously terminated, shall terminate, and :

- (a) the hirer or buyer shall be released from all liability under the agreement, and shall be entitled to recover from the owner or seller, in an action for money had and received, all sums paid by the hirer or buyer under the agreement or under any security given by him in respect thereof, and
- (b) any guarantor shall be entitled to recover from the owner or seller, in an action for money had and received, all sums paid by him under the contract of guarantee or under any security given by him in respect thereof."

"58 (i) "contract of guarantee, in relation to a hire-purchase agreement, credit-sale agreement or conditional sale agreement, means a contract, made at the request (express or implied) of the hirer or buyer, either to guarantee the performance of the hirer's or buyer's obligations under the hire-purchase agreement, credit-sale agreement or conditional sale agreement, or to indemnify the owner or seller against any loss which he may incur in respect of that agreement, and "guarantor" shall be construed accordingly;"

## T h e C o n s u m e r C r e d i t B i l l

The following extracts are taken from the Bill in the form in which it was after it had been amended by Standing Committee D in the last Parliament (5 February 1974). As a result of the General Election of March 1974, the Bill will have to be re-presented to Parliament. It will probably be passed eventually but may be further amended. If enacted, this Bill will apply throughout the United Kingdom. The Hire-Purchase Act 1965 (U.K.) and the Hire-Purchase (Scotland) Act 1965 (U.K.) will be wholly repealed; the Hire-Purchase Act 1966 (N.I.) will be almost wholly repealed.

### Part VIII

#### SECURITY

##### G e n e r a l

100. (1) Any security provided in relation to a regulated agreement or linked transaction but not embodied in the executed agreement shall be expressed in writing.

(2) The Secretary of State may make regulations prescribing the form and content of documents ("security instruments") to be made in compliance with subsection (1).

- (3) Regulations under subsection (2) may in particular :
- (a) require specified information to be included in the prescribed manner in documents, and other specified material to be excluded;
  - (b) contain requirements to ensure the specified information is clearly brought to the attention of the surety, and that one part of a document is not given insufficient or excessive prominence compared with another.
- (4) A security instrument is not properly executed unless :
- (a) any regulations made by virtue of subsection (2) which apply to the instrument are complied with, and
  - (b) a copy of the instrument is given to the surety, and to the debtor or hirer (if a different person), within seven days after it is executed, and
  - (c) a copy of the executed agreement, together with a copy of any other document referred to in it (otherwise than in a provision not forming part of the regulated agreement), is also given to the surety within seven days after the instrument is executed, and
  - (d) the instrument is signed by the surety.
- (5) If :
- (a) in contravention of subsection (1) a security is not expressed in writing, or
  - (b) a security instrument is improperly executed, the security is enforceable against the surety on an order of the court only.

(6) This section applies to a security provided in relation to a prospective regulated agreement or prospective linked transaction as it applies to one provided in relation to an actual regulated agreement or actual linked transaction, but where a security instrument is made in relation to a prospective regulated agreement, subsection (4)(c) shall apply with the substitution of "the regulated agreement is made" for "the instrument is executed".

101. (1) Where a default notice is served on a debtor or hirer, a copy of the notice shall at the same be served by the creditor or owner on any surety.

(2) If the creditor or owner fails to comply with subsection (1), the security is enforceable on an order of the court only.

102. (1) In determining whether or not to make an order under section 101 (2) the court shall consider, in addition to any other relevant factors :

- (a) how far, if at all, the surety has been prejudiced by the failure to comply with section 101 (1);
- (b) the degree of culpability for the default.

(NOTE : Clauses 103-6 concern the duty of the creditor to give certain information to the surety and the debtor. Clause 107 is concerned with the realisation of securities.)

108. (1) Where a security is provided in relation to an actual or prospective regulated agreement, the security shall not be enforced so as to benefit the creditor or owner, directly or indirectly, to an extent greater (whether as respects the amount of any payment or the time or manner of its being made) than would be the case if the security were not provided and any obligations of the debtor or hirer, or his relative, under or in relation to the agreement were carried out to the extent (if any) to which they would be enforced under this Act. (subsections (2) - (5) are omitted)

(6) Where an indemnity is given in a case where the debtor or hirer not of full age and capacity, the reference in subsection (1) to the extent to which his obligations would be enforced shall be read in relation to the indemnity as a reference to the extent to which they would be enforced if he were of full age and capacity. (subsection (7) is omitted)

#### D e f i n i t i o n s

The Consumer Credit Bill defines the following terms in clause 171 (1): "security", in relation to an actual or prospective consumer credit agreement or consumer hire agreement, or any linked transaction, means a mortgage, charge, pledge, bond, debenture, indemnity, guarantee, bill, note or other right which secures the carrying out of the obligations of the debtor or hirer under the agreement and is provided by him or at his request (express or implied).

"surety" means the person by whom any security is provided, or the person to whom his rights and duties in relation to the security have passed by assignment or operation of law.



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