Advising Guarantors

An introduction to guarantees

What is a guarantee?

• A guarantee is a form of "surety" along with indemnities

• A guarantee is not a credit agreement in its own right

Some creditors routinely require debtors to find a willing guarantor in order to lend money. Others will require a guarantor when the debtor has a poor credit rating or no assets. For the creditor, having a guarantor provides additional security, as the loan can be enforced against the guarantor in the event of a default by the borrower. The guarantor will become liable when the debtor defaults on payments. This may be immediately or at a later stage (for example when a default notice is issued). Guarantors will generally not have had the benefit of any borrowing.

All guarantees must be in signed writing – Statute of Frauds Act 1677.

Guarantees can be created by deed, and if the guarantee is provided after the contract with the debtor has been executed, it must be executed as a deed to be valid.

If the guarantee is provided jointly, all guarantors must sign (See *Harvey v Dunbar Assets Plc* [2013] EWCA Civ 952). We don't often come across agreements with multiple guarantors. However, if there is more than one guarantor, all the co guarantors must sign or

the guarantee is invalid. See *Harvey v Dunbar Assets Plc* [2013] EWCA Civ 952 paragraph 44.

There must be consent of the guarantor for variation of the guarantee. This is important to remember if there has been an increase in the amount of credit to the principal debtor. *Holme v Brunskill* 1878 3 QBD 495 held that if a guarantee is varied without the guarantor's consent the guarantor is released from liability unless the variation is 'self-evidently insubstantial or non- prejudicial' See 'Guarantors and Tenancy Agreements' in Adviser 140.

Consumer Credit Act and Affordability

Commercial loans to individuals will generally be regulated by the Consumer Credit Act 1974 (the CCA). For CCA regulated agreements, lender must also comply with the relevant section of the FCA handbook - CONC 4.2.22. These rules include a requirement to explain when a guarantee might be called in and the legal nature of a guarantee, and to conduct affordability checks.

Where these discussions have taken place over the phone, your client can obtain a recording of the telephone call by making a Subject Access Request. These requests are now free S105 of the Consumer Credit Act 1974 (CCA) provides for form and content of securities. The Act requires that guarantees must:

- Be in writing,
- Be In the prescribed form, conform to regulations, and be signed in the prescribed manner by the guarantor, and
- Contains all the terms of the security, other than implied terms, and
- Be legible, when presented and sent to be signed by the guarantor, and
- A copy must be provided.
- Further copies must be provided following a request under s107 CCA there is a £1 fee

Signing of guarantee document

Guarantees must be in writing and will not be properly executed unless there is a document in the prescribed form, containing all the prescribed terms and conforming to regulations, and is signed in the prescribed manner by the guarantor. Signatures can be electronic if the guarantor agrees (Consumer Credit Act Electronic Communications Order 2004, No.3236). In fact, it is now common practice for guarantees and credit agreements to be signed electronically.

Bassano v Toft and others [2014] EWHC 377 (QB) held that by clicking on a button entitled "I Accept" automatically populating a signature box with her name, the defendant had signed an agreement for the purposes of s61 of the CCA (Para 44). Previous caselaw also discussed at (42) of this judgment.

The document must contain all the terms of the security, other than implied terms, and the terms of document must be legible when presented and sent to be signed by the guarantor.

Requests for information

Creditors must also provide copies of guarantee agreements following statutory requests for copies of guarantee agreements under s107 of the CCA. Alternatively, a subject access request under articles 12, 15 and recital 63 of the General Data Protection Regulation. The data must be provided free of charge. See the Information Commissioner's website for more information.

Similar to requests for copies credit agreements under s77 of the CCA, requests can be made for information including copy agreements under s107 of the CCA. If a copy is not provided within 12 working days, then the guarantee will become unenforceable until such time as the lender complies.

Where a guarantee is provided after (or at the same time as) the credit agreement is made, a copy of the executed agreement and copies of any documents referred to in it must be given to the guarantor at the time the guarantee is made.

Where a guarantee is provided before a credit agreement is executed a copy of the executed agreement and copies of any documents referred to in it are to be provided to the guarantor within 7 days of execution.

Form and content of the guarantee

The Consumer Credit (Guarantees and Indemnities) Regulations 1983 contains the prescribed terms for regulations. These include:

- A prescribed heading that depends on whether the security is a guarantee, an indemnity or a guarantee and an indemnity (Schedule Regulation 3 Part I)
- The names, postal addresses and where appropriate other addresses of the principal debtor, creditor, and guarantor/s respectively
- The description of the subject matter to which the security relates. In most cases this will be the loan itself (Schedule Part II (d))
- Prescribed statement of the guarantor's rights (Schedule Part III)
- The signature box must contain a prescribed statement set out in part IV of the Schedule to the Regulations.

The wording in all prescribed statements must be followed exactly with no margin for error. Any minor mistake will therefore render a guarantee improperly executed. See *Goshawk Dedicated (No.2) Limited v RBS* [2005] EWHC 2906 (Ch) paragraphs 46 – 49.

Improper execution

Improperly executed guarantees or guarantees which are not in writing are only enforceable on an order of the court (s105(7) CCA).

If enforcement is refused by the court the guarantee is treated as never having effect (S106(a)) and any payments received in respect of the guarantee must be repaid to the guarantor (S106 (d)).

The improper execution of a guarantee agreement does not of itself make the agreement to which it relates improperly executed. However, if a debtor has a defence for example due to improper execution of the principal agreement, a guarantor has the same defence against the enforcement of the guarantee. See *Associated Japanese Bank (International) Ltd v Crédit du Nord SA* [1988] 3 All ER 902.

Unfair relationships

Caselaw has held that the unfair relationship provisions do not apply to guarantors because a guarantee is not a credit agreement as no credit is advanced under the guarantee. See *Clydesdale Bank plc v Gough & Gough* [2017] EWHC 2230 (Ch) (Paragraphs 109 –113) and also page 140 of CPAG Debt Advice Handbook 12th Edition. Note that the article from Adviser 149 'Guarantees, indemnities and the Consumer Credit Act 1974' was written before the courts clarified the position and incorrectly states that the unfair relationships provisions do apply.

Financial Ombudsman complaints

The Financial Ombudsman will accept complaints from guarantors where the agreement falls under their jurisdiction. FOS have dealt with a number of complaints about Amigo loans and found in favour of the consumer in around a quarter of cases in the first half of 2018. Data detailing the number of complaints from guarantors is not currently available.

Examples of cases where FOS upheld for the guarantor:

Amigo loans failed to undertake affordability checks Ref: DRN9240014

In this case FOS found that Amigo Loans had encouraged the prospective guarantor to reduce her existing expenditure to make the guarantee affordable. They instructed Amigo to remove Miss D as guarantor, end all contact with her about and ensure that no adverse information be recorded on her credit file. Amigo also had to pay Miss D £250 in compensation.

Amigo loans accepted guarantee without sufficient affordability checks and should have enquired into guarantor's understanding of agreement Ref: DRN9934663

In this case FOS found that Amigo Loans had failed to properly assess whether the repayments were affordable to the guarantor and that in fact she was never in a position to repay them. FOS agreed that Amigo's action to remove Mrs Y's liability under the guarantor was fair and reasonable given the circumstances.

Whilst previous FOS decisions are a useful guide it's important not to assume your client's case will be decided in the same way. It is important to explain why any legal or regulatory

breaches and your client's specific circumstances mean the lender has behaved in a way that is not fair and reasonable.

In our experience guarantor loan lenders can be quick to issue court proceedings. This might deny a guarantor the opportunity to have their complaint heard by FOS. In such circumstances a guarantor defendant can ask the court for an adjournment. In *Derbyshire Home Loans v Keany* (Bristol County Court 08/01/2007 unreported), the court adjourned proceedings to allow FOS to consider a complaint in accordance with Civil Procedure Rule 26.4. The Civil Court Practice 2018 (October reissue), *Butterworths*, contains a full commentary on the requirements for alternative dispute resolution with a view to compliance with CPR 1.4(2)(e) – *"active case management includes...encouraging the parties to use an alternative dispute resolution procedure if the court considers that appropriate and facilitating the use of such procedure"*. This rule is one of the ways by which the Court may fulfil that duty.

If possible, it is preferable to make a formal complaint and have it considered by FOS before resorting to a remedy in the courts. Rule 3.6.6(4) of the Dispute Resolution part of the FCA Handbook confirms that where a complainant does not notify FOS of acceptance of their decision this will be taken as rejecting the decision and neither side will be bound by it. If a complaint is not upheld the consumer may still have a legal remedy.

Duress and undue influence

A guarantor may report feeling pressured into agreeing to providing a guarantee. This may be a way for the guarantor to challenge liability under the agreement.

Undue influence is an equitable remedy allowing a transaction to be set aside where one party, usually in a position of trust, has pressured the other party into entering into an agreement.

Undue influence involves pressure applied by a person in a position of trust. The actions need not involve fear or intimidation, although actual (rather than presumed) undue influence may include unlawful acts. Primarily undue influence is intended to cover situations where a contracting party has been forced, tricked or misled - *Allcard v Skinner (1887)* 36 ChD 145 at 183, CA, per Lindley LJ.

Similar to undue influence, duress is a remedy in contract law. It requires one party to have intimidated, issued threats, used force or otherwise coerced the other party.

Duress usually involves conduct which is unlawful, such as violence, and it does not require any pre-existing relationship of trust between the parties. In a domestic situation there may be elements of duress along with undue influence. Actions amounting to duress should be reported to the police, especially if it is to be relied on in court to avoid liability under a contract. The actions constituting duress could have been directed at the spouse, child or relative of the contracting party*. Interestingly, where the threats or violence have been made out, the burden of proof is shifted to the defendant to show that those actions DID NOT contribute to the decision to enter into the contract. The duress does not need to be the only reason but must be a significant contributing factor.

The remedy for both undue influence and duress is rescission of contract, and in a domestic situation there may be elements of both, and it common for both to be pleaded in the same proceedings. Rescission puts the parties back in the position they were in at the start. For the guarantor, it means the guarantee provided under duress/undue influence is declared void. This may have implications for the principal debtor.

* *Williams v Bayley (1866)* LR 1 HL 200 (son); *Sear v Cohen (1881)* 45 LT 589 (nephew); *Jones v Merionethshire Permanent Benefit Building Society* [1892] 1 Ch 173, CA (mother-in-law and brother-in-law)

Creditor's responsibilities to guarantor

The arrangement must be a non–commercial transaction: the guarantor places "trust and confidence" in the debtor. If money is paid to the guarantor in return for providing the guarantee, it will constitute an indemnity and different rules apply. Most guarantees we see are provided by a family member or friend and are non-commercial.

A failure to explain the risks and advise the guarantor to seek such advice may result in a 'rebuttal' presumption of undue influence.

'Irrebuttable' presumptions of undue influence apply to certain established relationships (e.g. parent and child, trustee and beneficiary, solicitor and client).

A defence of ‘actual’ undue influence can be raised where there is evidence.

Etridge

Bank of Scotland v Etridge No.2 (and other appeals) [2001] UKHL 44 acknowledged that the relationship must be one where a party has placed sufficient trust and confidence in the other [paragraph 10].

Etridge confirmed that where a wife provides security for the borrowing of her husband and gains no financial advantage from it, a bank is put on notice (known as constructive knowledge) of the possibility of undue influence (See paragraphs 44 and 46). The creditor should then take reasonable steps to underline the risk of providing security to the wife and recommend she seeks independent legal advice. Failure to take these steps may give rise to a presumption of undue influence which can rebutted by evidence that no such undue influence or misrepresentation took place.

Etridge also held at paragraph 18 that the parent and child relationship is an example where an irrebuttable presumption of undue influence would arise (other examples are solicitor and client and guardian and ward). This recognised example is undue influence of a parent over a child rather than the more common scenario of a parent guaranteeing a child’s loan.

There is no presumption (rebuttal or otherwise) of undue influence where a parent guarantees a child’s loan. A parent relying on such a defence would need to show that they reposed trust and confidence, that the transaction was not otherwise explainable, that it was a non-commercial transaction, and that there was actual undue influence (e.g evidence of pressure or coercion).

For a defence based on undue influence or duress to succeed, the creditor needs to have knowledge, or “constructive knowledge” of the situation.

What is constructive knowledge?

Constructive knowledge amounts to being put on notice of a situation where reasonable care could reveal undue influence or duress.

It does not require the creditor to be aware of the undue influence or duress

In *RBS v Etridge* the court held that reasonable care includes advising a wife to take legal advice independently of her husband when she is providing surety for his business debts.

The decision in *Etridge* can be applied directly to guarantor loans. As in *Etridge*, it may not make financial sense for a spouse to be guarantor, and so enquiries should be made. Where the debtor and guarantor are not in a relationship undue influence can be harder to make out (although any non-commercial relationship should put a creditor on notice).

Obtaining relief

A guarantor who has been a victim of undue influence can apply to court to set the transaction aside. This is a part 8 claim issued on a form N208. The claim will be listed in the multi track, where costs are high and the rules are strict. Legal aid is not available for this type of claim. We recommend guarantors complain to the creditor and escalate the complaint to the Financial Ombudsman Service where appropriate.

A guarantor could instead wait for a claim to be issued and defend it. Arguments around undue influence could be complex, so the case might be listed in the fast track or multi track even where the value of the claim is under the small claims limit. Representations can be made to the court about the disproportionate effect of multi track costs on a litigant in person.

The call recording will be vital evidence in court or if the guarantor makes a complaint to FOS.

Insolvency of the guarantor

Where the guarantor is in financial difficulties it might be appropriate for them to consider personal insolvency. The rules about guarantees in bankruptcy, Debt Relief Orders (DROs) and Individual Voluntary Arrangements (IVAs) are slightly different for each one and need to be considered carefully.

Guarantees in bankruptcy

Section 382 of the Insolvency Act 1986 defines “Bankruptcy debt” as follows:

“(a) any debt or liability to which he is subject at the commencement of the bankruptcy,

(b) any debt or liability to which he may become subject after the commencement of the bankruptcy (including after his discharge from bankruptcy) by reason of any obligation incurred before the commencement of the bankruptcy.”

Guarantee liabilities will prove in a guarantor’s bankruptcy whether or not the debtor has not defaulted and the guarantee has become due and payable.

Where the debtor has not defaulted the guarantee will constitute a contingent liability. Note also that if the principal debtor is adjudged bankrupt the guarantor will remain liable (See s281(7) Insolvency Act 1986).

Guarantees in a Debt Relief Order

A qualifying debt...”is for a liquidated sum payable either immediately or at some certain future time” - S251A (2) (a) of the Insolvency Act 1986.

This does not include contingent liabilities.

Whether or not a guarantee constitutes a DRO qualifying debt depends on the agreement. It may be automatic, following the default of the debtor and expiry of a properly served default notice or it could require expiry of the default notice and a demand for payment from the creditor. Default notices must be served on the debtor and the guarantor.

It is important to check the agreement and the notices if there is any uncertainty about whether the guarantee has been called in.

For a CCA regulated agreement, a guarantee will become a liquidated sum and therefore a qualifying debt, when a default notice has been served on both the debtor (s87(1)(e)) and the guarantor (S111(1)).

Agreements should be checked for enforceability and to determine when the guarantor’s liability crystallises and becomes a qualifying debt. Advisers should check that default notices been properly served and have expired. Page 141 of the CPAG Debt Advice Handbook 12th Edition discusses the FCA guidance on what constitutes ‘enforcement’ requiring the service of a default notice under S87 of the CCA. Demanding payment from

the guarantor or taking payment from her/him via a continuous payment authority without proper prior notification is enforcement. This is unless the guarantor is given a least 5 days notice before the payment is taken and reminded that the continuous payment authority or direct debit can be cancelled.

Voluntary payments by the guarantor does not count as enforcing security nor is requesting payment, provided it is made clear it is not a demand.

Guarantees in an IVA

Where the guarantor makes an IVA proposal the guarantee liability should be included. If the guarantee has crystallised the creditor will have voting rights. In accordance with rule r15.31(3) of the Insolvency Rules 2016 where the liability is not yet due and payable the debt will be listed as £1.00 unless the convener decides to give a higher estimated value. Importantly, the creditor will have no voting rights. In *Fender v IRC* [2003] BPIR 1304 at para 15 the court rejected the argument that the holder of a guarantee was entitled to vote in respect of the debtor's maximum possible liability under it, even though no sum was payable at the date of the creditors' meeting and the actual sum that might ultimately be payable could not be determined.

The legal text Schaw Miller and Bailey comments [at 6.209] that the same presumably holds for the decision procedure valuing the guarantee. As with any contingent claim, the value of a claim under a guarantee must be valued in its particular circumstances and given a value of £1.00 if it is not reasonably possible to ascribe a higher value to it. How would it be reasonable to give a higher guarantee without knowing how much the principal debtor might repay?

An Insolvency practitioner from a reputable firm has stated that Amigo tend to vote against IVAs, but would have no voting rights as long as the guarantee liability has not been crystallised. This is particularly useful for homeowners wishing to avoid enforcement by charging order.

Uncrystallised guarantees will still be bound by the IVA and the guarantor's liability will be discharged if it successfully concludes. (See *Re T&N Ltd and others (No 2)* [2005] EWHC 2870 (Ch) at paragraph (46).

Unjust enrichment and subrogated rights

The guarantor might have paid off all or part of the loan. This could have followed a request for payment, where the guarantor has voluntarily brought the account up to date, or a demand, where the guarantor has become liable under the terms of the guarantee. This would give the guarantor a claim in restitution.

Restitution is the law of gains-based recovery. It is an equitable remedy, which means the court can take into account what is fair, including to the defendant.

Where:

A has been enriched

The enrichment was at B's expense, and

The retention of the enrichment was unjust

B has a claim against A in restitution – *Banc Financiere v Parc* [1998] 1 All ER 737

A claimant might have enriched a defendant by paying a debt owed by the defendant, discharging an obligation, saving the defendant from an expense or conferring some form of benefit - *National Bank v Oman Housing* [2002] EWHC 1760 (Comm).

This might occur in other debt situations, such as when a debt is paid by a partner, or if one joint debtor pays the whole debt. The person who has paid must show that the other person has made a direct gain from their loss.

Unjust enrichment can apply in cases of quantum meruit and quantum valebat (or money's worth claims).

The defences to a claim in restitution for unjust enrichment include:

- Estoppel
- Bona Fide purchaser for good consideration
- Change of position renders it inequitable "Where an innocent defendant's position is so changed that he will suffer an injustice if called upon to repay...the injustice of requiring him to so repay outweighs the injustice of denying the plaintiff restitution" - *Lipkin Gorman v Karpnale* [1991] 4 All ER 512.

Quarterly Account IMA 13 contains an article on Estoppel that considers these points in more detail.

Subrogation

Subrogation describes the situation where one party substitutes another, usually as part of a debt or insurance claim, along with the transfer of rights and duties. It can be described as "stepping into the shoes" of a party to a claim.

A guarantor who pays a debt to a creditor can step into the shoes of that creditor and pursue a claim against the debtor. The individual that receives subrogated rights also gets the benefit of any judgment or security that might be available to the creditor.

A person relying on subrogated rights will also have the duties of the creditor. For agreements regulated by the CCA the duties will make it impossible for clients to comply. In practise this probably wouldn't matter as the guarantor would have a right to be indemnified in these circumstances. This has the same effect as subrogation, without the requirements of being a "creditor" within the meaning of the CCA.

The right of action as an asset

Where a guarantor has paid off the principal debt they will have a right of action in restitution. This may be an asset for the purpose of a DRO. The DRO Team have provided the following advice:

"A DRO applicant would need to demonstrate what action, if any, had been taken to seek recovery. If it is clearly demonstrated that the debt is bad and irrecoverable, it would not be scheduled as an asset. For a debt to be bad and irrecoverable, the person owed the money must have taken all reasonable steps to try to get it back.

These steps could include taking enforcement action through the courts process or instructing tracing agents."

In bankruptcy, the right of action will vest in the Official Receiver who will make a commercial decision regarding recovery of the debt.

Acknowledgments and further reading

'Guarantees. Indemnities and the Consumer Credit Act 1974' by Guy Skipwith published in issue 149 of the Citizens Advice Adviser journal.

'New FCA Rules to Protect Guarantors' by Graham O'Malley published in issue 39 of the Institute of Money Advisers Quarterly Account journal.

'Guarantors and rent arrears' by Lesley Groves published in issue 140 of the Citizens Advice Adviser journal.

'Estoppel' by Alexa Walker and David Crooks published in issue 13 of the Institute of Money Advisers Quarterly Account journal.