Challenging a creditor’s right to call a personal guarantee
Personal Guarantees

Introduction

Personal Guarantees are more common now than ever and creditors can be quick to take action against a guarantor. However, not all personal guarantees are enforceable. This article explains how you can defend a guarantee claim.

If you have given a personal guarantee and the creditor is seeking to enforce it, you should seek legal advice first as you may have grounds to challenge its validity.

Patrick Selley, who specialises in bringing claims against banks, financial advisors and financial institutions, explains that despite some creditor's best efforts, many individuals have successfully avoided some or all of their liability under a personal guarantee. In this, the first of a series of four articles, Patrick sets out the grounds for a successful challenge to the terms of the guarantee itself.

What is a guarantee?

A guarantee is a particular type of contract (suretyship) whereby one party, the "guarantor", agrees to be liable for the obligations of another party, the "principal". Generally speaking, the guarantee will be expressed to be in favour of a third party creditor which in most cases is a bank. Usually, the obligation being guaranteed will be that the principal will repay the third party a sum of money on or by a particular date. In a guarantee, the guarantor promises the third party that, in the event of the principal not performing its obligation, the guarantor agrees to perform it instead.

Key issues for challenging a personal guarantee

When considering whether the personal guarantee can be enforced, there are four key questions to be answered:

- Are there any defences available to the guarantor?
- Has the creditor proceeded correctly against the guarantor?
- Are there any claims available to the principal against the creditor that can be relied on by the guarantor in reducing the guarantee liability?
- What documentation is there that will evidence the guarantor’s arguments on one of the three grounds listed above and who has such documents?

This article concentrates on the first of these four key questions by examining the extent to which individual terms in a guarantee may be successfully challenged.

Breaching the equitable principles

When faced with a guarantee claim, one of the most important arguments that you can advance is that the creditor's actions have rendered the guarantee unenforceable pursuant to the equitable principles of suretyship.
These equitable principles arise independently of the intentions of the parties and, to some extent, independently of the contractual terms. Further, the creditor, its employees and on occasion its legal team often do not understand these equitable principles.

One of the clearest examples of the operation of the equitable principles can be found where the creditor allows the principal more time than permitted in the guarantee to pay the guaranteed sums, or varies the terms of the initial loan to allow for further borrowing. In such cases, the creditor may have rendered the guarantee unenforceable.

Other common examples of conduct on the part of the creditor that may render its guarantee unenforceable include:

- where the creditor deals negligently with other security held by it in respect of the same liabilities; and
- where the creditor alters the liability of the principal under the loan without the knowledge and consent of the guarantor.

Unsurprisingly lenders have sought to exclude these equitable principles through express wording added to the guarantee, for example:

"From time to time we may provide the customer with any credit or facilities, vary cancel or refuse credit, give the customer more time to pay, make any other arrangement, compromise with the customer, take or deal with any security ... If we carry out any of the above acts, or do or fail to do anything else this will not affect our rights under this guarantee".

The Unfair Terms in Consumer Contracts Regulations 1999

The Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR), as its name suggests, applies only to consumer contracts and has the effect of rendering unenforceable any terms which are adjudged to be ‘unfair’.

According to the UTCCR, "consumer means any natural person who, on contracts covered by these regulations, is acting for purposes which are outside his trade, business or profession".

When creditors require a director of a company to give a guarantee, it is arguable that the guarantee is not given by the director ‘as a director’ but rather that it is given by him in his capacity as shareholder, and is therefore not given by the director in the course of his trade business or profession.

Often guarantees are given by the guarantor’s spouse as well, so as to include the martial home as an asset which is available to the creditor should it need to enforce the guarantee. In such a case, the spouse can also argue that the term of the guarantee that excludes the equitable principles is unfair and so the guarantee should not be enforceable. Indeed, there is a higher likelihood of success for the spouse, where they are not involved in the company. In such a case it is highly advisable to seek legal advice before reverting to the creditor.

Where a term is considered unfair where it "has not been individually negotiated [it] shall be regarded as unfair if, contrary to the requirement of good faith, it causes significant imbalance in the parties' rights and obligations arising from the contract, to the detriment of the consumer." A "term shall always be regarded as not having been individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term".
The courts will assess the unfairness of a contractual term, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of contract or of another contract on which it is dependent.

**Convincing the court that a term is unfair**

Only the court can determine whether a term is unfair. However, the creditor might not wish to incur the expense of legal proceedings it may lose and may therefore decide not to enforce the guarantee or to settle.

In both cases, a guarantor will need to advance a strong argument and to produce as much supporting evidence and documents as are available. Where the creditor holds relevant documentation, the guarantor is entitled to be provided with copies upon request. Creditors are often slow to recognise the extent of relevant documents that they hold, or are just reluctant to produce them and therefore properly framed requests for documents are important in defending guarantee claims.

If you wish to challenge a personal guarantee, you need to plan a strategy carefully. Given the potentially high cost of litigation, it may be preferable to reach a settlement with the creditor. The terms of such settlement can be affected by the manner and timing of contact with the creditor. Careful and targeted use of disclosure requests for documentary evidence of matters which would go to the question of unfairness can be a useful tool in bringing about an advantageous settlement.

**Conclusion**

It is often possible to challenge a creditor’s right to enforce a personal guarantee. However, doing so is rarely simple and legal advice from a specialist in this area is highly advisable.

Unsurprisingly, creditors will firmly reject any challenge to a personal guarantee and have standard methods of so doing. The analysis of the relative merits of their counter-arguments is important.

Also it should not be forgotten that in most cases the creditor is a bank, and that currently the banks do not wish give the courts the opportunity to strike down a personal guarantee, as to do so would set a dangerous precedent potentially affecting thousands of guarantees held by them. As a result, when confronted with a well advised guarantor, the banks’ firm rejections can give way to a willingness to settle.

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