CO-GUARANTORS

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This note explains the implications of a lender taking guarantees from more than one person over the same debt. It considers the legal position from the perspective both of the lender and of the co-guarantors.

John Robb, Barrister, Essex Court Chambers

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SCOPE OF THIS NOTE

This note explains the implications of a lender taking guarantees from more than one person over the same debt. It considers the legal position from the perspective both of the lender (see, *What do lenders need to be aware of when taking a guarantee from co-guarantors?*) and of the co-guarantors (see *What rights do co-guarantors have against each other?*).

As elsewhere in the law of guarantees, the rights and obligations of the parties depend on a combination of:

- The particular contractual arrangements.
- The background rights developed by the courts to protect guarantors.

These equitable rights will often be excluded or modified by the terms of the relevant guarantees and associated documents.

The key underlying principle is that where a debt has been guaranteed by more than one guarantor, then, absent any contrary agreement, the co-guarantors should pay an equal amount if any one of them is called upon to

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pay under that guarantor's guarantee. This is achieved by allowing a lender who has paid more than their fair share to make a claim for "contribution" against their co-guarantors. For the same reason, co-guarantors have important rights of recourse to any securities held by co-guarantors for the guaranteed debt: this doctrine, called "hotchpot", is considered further below (see *What rights do co-guarantors have against each other?*).

This note does not deal in any detail with the rights of a guarantor against the principal debtor (that is to say under an indemnity), nor with the rights of a guarantor against parties other than co-guarantors (that is to say, subrogation, marshalling, and the right to be wholly or partially discharged from liability in the event of the lender culpably prejudicing the guarantor's security). These topics are dealt with in *Practice notes, Enforcing guarantees: guarantor's rights* and *Guarantees: termination and discharge*. This note focuses instead on the rights and liabilities arising between co-guarantors, as well as on specific drafting and legal issues to be considered by a lender when taking a guarantee from co-guarantors.

WHAT IS A CO-GUARANTOR?

Where two or more persons guarantee the same debt, they are "co-guarantors". Provided that the co-guarantors' liability is for the same debt, it does not matter for these purposes whether that liability is joint, several, or (as is most common) joint and several (see *Joint and several liability*). Nor does it matter whether the co-guarantors know of each other's existence at the time of entering into their respective guarantees.

It is important to note that two people will be co-guarantors even if they have not signed the same contract of guarantee. They may instead have signed two separate but practically identical contracts of guarantee; or have signed otherwise different guarantees which happen to guarantee (part or all of) the same debt. The co-guarantors may have set different limits on their maximum liability under their respective guarantees; this does not prevent them from being co-guarantors.

Co-guarantors should be distinguished from:

- Guarantors of different obligations.

- Guarantors of different parts of the same debt.

- Sub-guarantors. A person (the "sub-guarantor") may promise that if a guarantor does not perform its guarantee obligations, that sub-guarantor will perform them on the guarantor's behalf. A sub-guarantor guarantees the obligation of a guarantor. So, if A and B guarantee that C will pay D, and X then guarantees that A will perform its guarantee obligations, A and B are co guarantors, and X is not a co-guarantor in relation to A or B.

- Ex-guarantors. Where the burden of a guaranteed debt is assigned with the consent of the lender, or the lender assigns the debt, and a new guarantee is taken for it, the new guarantor cannot seek contribution from the previous guarantor, because they are not liable on a common demand, see *Ellesmere Brewery Co v Cooper [1896] 1 QB 75, 79*.

WHAT DO LENDERS NEED TO BE AWARE OF WHEN TAKING A GUARANTEE FROM CO-GUARANTORS?

When a lender takes a guarantee over a particular debt (or a part of that debt) from more than one guarantor, the lender will wish to consider:

- How to structure the liabilities of the different guarantors.

- When each of the co-guarantors is to become liable under their respective guarantee.

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JOINT AND SEVERAL LIABILITY

Two or more people are *severally liable* if they make separate promises to a third person. Those promises may be contained in the same instrument or in different instruments. If A and B promise C that they will each pay C £100, their promises are several. B remains liable to pay £100 after A has paid £100.

Two or more people are *jointly liable* if they jointly promise to do the same thing. There is only one obligation; if one of the joint promisors performs the obligation, then it has been discharged and the remaining joint promisors are under no further obligation.

Two or more people are *jointly and severally liable* if, in the same instrument, they jointly promise to do the same thing and also severally make separate promises to do the same thing. The result is one joint obligation and as many several obligations as there are promisors. The co-promisors are not cumulatively liable: it is like joint liability in this respect. Therefore, if one of the promisors performs the obligation, all are discharged.

See further, Professor Hugh Beale, *Chitty on Contracts* (Sweet and Maxwell, thirty-second edition, 2015), Volume 1, Chapter 17 (Chitty), at paragraphs 17-01 to 17-03.

- Whether one of the co-guarantors' liabilities is intended to be conditional on the other co-guarantors assuming liability. (See further *Conditional or independent liabilities of co-guarantors*.)

The lender will also wish to protect itself by ensuring that:

- Any steps it takes in relation to one guarantor (in particular discharging the guarantor, granting additional time for payment, or releasing security provided by that guarantor) will not affect the obligations of the remaining co-guarantors.

CONDITIONAL OR INDEPENDENT LIABILITIES OF CO-GUARANTORS

Whether one guarantor's liability is conditional upon the signature of an intended co-guarantor is a question of construction of the guarantee. The presumption where there is a single document prepared for signature by several persons, will be that none of the intended signatories is liable until all have signed. Where separate documents are prepared, each for separate signature by a separate individual, the contrary presumption applies, see *Capital Bank Cashflow Finance Ltd v Southall [2004] EWCA Civ 817* at paragraph 17 per Mance LJ. Where a lender takes separate guarantees from a number of different co-guarantors, the fact that the documents are all part of a larger transaction is not in and of itself sufficient to displace the presumption that each co-guarantor is liable upon signature of their own guarantee.

It will therefore be in a lender's interests to take separate guarantees from each co-guarantor, while it may be in the guarantors' interests to sign a single joint, composite guarantee. In *Harvey v Dunbar Assets plc [2013] EWCA Civ 952*, a single composite guarantee was purportedly signed by four co-guarantors. One subsequently claimed that his signature had been forged. The Court of Appeal held that, if he succeeded at trial in establishing that his signature had been forged, it would follow that none of the putative co-guarantors had ever become liable under the guarantee, since their liability was conditional on all four co-guarantors signing. This result would have been avoided if four separate guarantees had been signed, or if suitable contrary wording had been included in the guarantee.

It may be noted that the guarantee did provide that the guarantors' obligations and the bank's rights would not be:

> "discharged, impaired or otherwise affected by … any failure to take or fully to take any security contemplated by or otherwise agreed to be taken in respect of the Principal Debtor's obligations";

but this had no effect on the question of whether the putative guarantors had ever become liable under the guarantee in the first place.

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- The co-guarantors are not permitted to enforce any contribution claims between themselves until the whole of the principal debt has been repaid.

WHAT RIGHTS DO CO-GUARANTORS HAVE AGAINST EACH OTHER?

The first remedy of a guarantor who has paid or become liable to pay out to a lender under a guarantee, is to claim an indemnity against the principal debtor. Frequently, of course, the principal debtor will be insolvent or otherwise not worth suing; and in these circumstances, the guarantor will wish to seek what recourse it can against any co-guarantors.

A guarantor's principal right against its co-guarantors is the right to claim contribution. Contribution developed as a claim in equity, but is now primarily treated by English law as a personal claim in unjust enrichment, which will reverse any unjust enrichment which would otherwise be caused by one surety having to pay more than its fair share. It allows a co-guarantor who has paid more than its rateable share of the common liability for the principal debt as between that guarantor and its co-guarantors to demand contribution from them in proportion to their respective liabilities.

A guarantor may also benefit from various ancillary rights, in particular rights to benefit from securities held to secure performance of the guaranteed obligation:

- Right to *quia timet* relief to compel that guarantor's co-guarantors to contribute towards the discharge of the shared debt even before that guarantor makes payment to the lender.

- Hotchpot, that is, the right to benefit from securities held by co-guarantors for the principal debtor's performance of its debt.

- Subrogation to (secured or unsecured) claims previously held by the lender against the co-guarantor (or co-guarantors).

- Right (as against the creditor) to be wholly or partially discharged from liability, on account of the creditor's failure to retain claims against co-guarantors.

Claims to contribution, hotchpot and *quia timet* relief are considered in more detail below.

Contribution

A co-guarantor who has paid more than its rateable share of the common liability for the principal debt as between that guarantor and its co-guarantors is entitled to claim contribution from them in proportion to their respective liabilities. This is an application to the law of guarantees of the general doctrine of contribution, which applies to situations where one joint debtor pays more than its fair share of a common debt.

The historical origins of the claim for contribution lie in equity, but it is now more commonly analysed by English courts as being a part of the law of unjust enrichment. On either analysis, the ingredients of a claim in contribution are that:

- The claimant and defendant are both guarantors for the same debt (or part of a debt) owed to the same lender.

- The claimant has paid the creditor in accordance with the terms of the guarantee.

- The claimant has paid more than its rateable share of the liability shared with the defendant.

- The defendant has paid less than its rateable share of the liability shared with the claimant.

- There are no defences to the claim (see, *What defences are there against these rights?*).

In addition to the common law or equitable action for contribution, there is also a statutory right to contribution under *section 1* of the Civil Liability (Contribution) Act 1978. Confusingly, some co-guarantors' claims will have to be

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brought under the statutory claim, and some under the common law claim. While the substantive outcome ought to be the same whether the claim is brought under the statute or at common law (provided that the right route has been taken for the type of guarantee in question), it appears that the limitation period is different: see *How long is the limitation period on claims against co-guarantors?*). The rest of this article assumes that the claim is brought under the common law action, or that if the claim is being brought under the statute then the outcome will be the same as it would have been under the common law action. The question of whether a contribution claim should be brought under the statute or the common law action is dealt with in *Contribution and the Civil Liability (Contribution) Act 1978*.

See also *Practice note, Enforcing guarantees: guarantor's rights: Rights against co-guarantors*.

Contribution and the Civil Liability (Contribution) Act 1978

An unintended and unfortunate source of additional complexity in the law relating to contribution claims by co-guarantors is that some claims will be governed by the *Civil Liability (Contribution) Act 1978* (Civil Liability Act 1978), and not by the common law / equitable claim for contribution. It appears that this distinction will make a difference for limitation purposes (contribution claims having a six year limitation period while claims under the Civil Liability Act 1978 have a two year limitation period, see further *How long is the limitation period on claims against co-guarantors?*). It is theoretically possible (though highly unlikely in practice, and contrary to the intentions of the drafters of the Civil Liability Act 1978) that the amount of contribution claimable under the statute could be different from what could have been claimed at common law, since under *section 2(1)* of the Civil Liability Act 1978 the Courts have discretion to award contribution "...such as may be found by the court to be just and equitable having regard to the extent of that person's responsibility for the damage in question".

In essence, as the law currently stands:

- If the co-guarantors' obligations under the guarantee (or guarantees) sound in debt , then any claims for contribution should be brought under the common law / equitable action.

- If, however, the co-guarantors' obligations under the guarantee(s) sound in *damages*, then any claims for contribution must be brought under *section1(1)* of the Civil Liability Act 1978. This provides that: "... any person liable in respect of any damage suffered by another person may recover contribution from any other person liable in respect of the same damage (whether jointly with that person or otherwise)." *Section 6(1)* of the Civil Liability Act 1978 expands on the meaning of the expression 'liable in respect of any damage'; and *Section 7(3)* provides that where section 1 applies it supersedes any pre-existing common law right to contribution.

Whether the co-guarantors' obligations sound in debt or damages will depend on (the largely arbitrary question of) whether the wording of the guarantee provides that either the principal debtor fails to perform its obligation then the guarantor(s) will perform it, or the guarantors promise that the principal debtor will perform its obligation.

The former gives rise to a liability in debt, and the latter to a liability in damages, if the principal debtor fails to perform its obligation. Which category a particular guarantee falls into may be disputed; the relevant authorities are discussed in Geraldine Andrews and Richard Millett, *The Law of Guarantees*, (Sweet & Maxwell, Seventh edition, 2015) (Andrews & Millett) at *paragraph 6-02*. Even more pessimistically, Goff & Jones, *The Law of Unjust Enrichment* (Sweet & Maxwell, Eighth edition, 2011) (Goff & Jones) concludes at *paragraph 19-33* that "Many guarantees roll these forms of wording together... in which case it is impossible to be sure whether or not a court will find the contribution claim to fall within the statute".

It may be noted that if two people give indemnities (rather than guarantees) for the same debt, then if one pays more than its fair share, that indemnifier will be able to claim contribution from the other under the Civil Liability Act 1978. Liability under an indemnity sounds in damages, not in debt.

Central to the claim in contribution is the concept of the fair or "rateable" share of the common liability owed by each co-guarantor. In the absence of any contrary agreement between co-guarantors and/or in the co-guarantors' respective guarantee agreements with the lender, each co-guarantor is required to contribute equally.

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- **Example 1**: A, B & C all guarantee X Co's overdraft to Y Bank up to a limit of £1.5 million. X Co becomes insolvent, owing £1.5 million under its overdraft to Y Bank. Y Bank claims the full £1.5 million from A, who pays the £1.5 million and is then entitled to claim £500,000 against each of B and C.

If one or more of the co-guarantors is insolvent at the time when contribution is sought, the initial burden of contribution will be shared between the solvent co-guarantors. The estate of the insolvent co-guarantor remains liable to contribute, and a co-guarantor who has paid the whole of the guaranteed debt is entitled to prove in the insolvent co-guarantor's bankruptcy or liquidation (see further Andrews & Millett at *paragraph 12-025*). Any dividends obtained from the bankruptcy or liquidation must be shared with the other solvent co-guarantors.

- **Example 2**: X's debt to Y is guaranteed by A, B, C and D, each of whom give guarantees up to a limit of £1.2 million. X and C become insolvent, and Y claims £1.2 million from A, who pays. A is entitled to claim contribution from B and D, initially in the sum of £400,000 from both. A is also entitled to prove (in Y's name) in C's bankruptcy. If A succeeds in recovering £150,000 from C's bankruptcy, then that dividend would have to be shared with the other solvent co-guarantors, such that the final net contribution of each of A, B and D would be £350,000.

It is not uncommon for co-guarantors to have guaranteed the common debt up to different limits. In this scenario, each is required to contribute in proportion to the limit that it has guaranteed.

- **Example 3**: A, B and C each guarantee X Co's overdraft to Y Bank. Each guarantees the full overdraft, but A's guarantee is limited at £5 million, B's at £2 million and C's at £1 million. X Co becomes insolvent, and £2 million remains owing to Y Bank under the overdraft after Y Bank has realised certain fixed and floating charges that it held as security over X Co's assets. Y Bank sues B for the full £2 million. B pays, but is entitled to recover contribution from A (£1,250,000, i.e. 5/8 of £2 million) and from C (£250,000, i.e. 1/8 of £2 million).

If a guarantor (A) has paid more than its fair share of the sum so far demanded by the lender, but part of the guaranteed debt remains outstanding so that if the remainder were repaid by one of the other co-guarantors (B) the burden as between A and B would be equally shared, A will not be entitled to claim contribution (against any of its co-guarantors). This is on the basis that:

> "... until the whole debt has been paid by one surety, or so much of it as to make it clear that, as between himself and his co-sureties, he has paid all that he can ever be called upon to pay, there can be no equitable debt from them to him in respect of it"

(see, *Re Snowdon (1881) LR 17 Ch D 44*, 47 (James LJ)).

- **Example 4**: The facts are the same as in example 3, but X has so far demanded only £500,000 from B (who has paid). Even though A and C have not yet paid anything, they are not yet liable to pay contribution to B, because Y Bank could choose to recover the remaining £1.5 million from A and C (or from A alone), in which case B would not have made any overpayment. If Y Bank subsequently takes no further steps to enforce the outstanding £1.5 million against any of the guarantors, with the result that the debt becomes statute-barred, then at that point B will have paid more than its fair share and will be entitled to contribution. In this scenario, the total debt is £500,000, which should be divided between A, B & C in the proportion 5:2:1. B, who has paid £500,000, would therefore be entitled to £325,000 from A and £62,500 from C.

  If, changing the facts slightly, Y Bank demands and receives £1 million at the outset from B (reserving its right to claim the remaining £1 million), then B would at that stage be entitled to recover contribution in respect of the £500,000 which it is already clear is more than B's rateable share of the full principal debt. B would presumably be entitled to claim 5/6 of the £500,000 from A and 1/6 of the £500,000 from C.

Finally, a guarantor may be entitled to contribution from its co-guarantors where that guarantor pays an amount which is not in excess of its rateable share, but which is accepted by the lender in full satisfaction

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of the whole of the guaranteed liability. It is important, when a guarantor enters into a settlement with the lender in this way, for the guarantor to notify and (if practicable) obtain consent to the settlement from the co-guarantors; this is to prevent the co-guarantors defending the claim for contribution on the grounds that the lender's claim could have been resisted or settled on better terms, see Andrews & Millett at *paragraph 12-020*. Note that the position is different where the guarantor's claim for contribution is brought under the Civil Liability Act 1978 as a result of *section 1(4)* of that Act.

- **Example 5**: A, B and C each guarantee a debt of £1,000 in the proportions £200, £300 and £500. The lender agrees to accept £500 from C in satisfaction of the entire debt. A, B & C should therefore contribute towards the £500 in the proportions 2:3:5. Since C has paid £500, C is entitled to contribution of £100 from A and £150 from B, leaving C footing £250.

The proportion payable by a particular co-guarantor is unaffected by whether that co-guarantor is jointly, severally or jointly and severally liable with the other co-guarantors under its guarantee. Nor is it relevant whether the co-guarantors knew of each other's existence at the time they entered the guarantee.

Hotchpot

Equity and/or the law of unjust enrichment protect a guarantor by giving it important rights to the benefit of securities held to secure performance of the guaranteed obligation, whether these are held by the lender, the principal debtor or by co-guarantors. This protection is achieved by:

- Requiring the person holding the security to take reasonable care not to lose it or use it in a manner unfairly damaging to the guarantor.

- Permitting a guarantor who has paid the creditor to take the benefit of any security rights which would otherwise have been extinguished as a result of the obligation they secure being fulfilled.

The primary instance of this is a guarantor's right, upon payment of the guaranteed debt, to be subrogated to all of the rights (including security rights) that the lender previously enjoyed against the principal debtor (see *Practice note, Guarantees and indemnities: overview: Subrogation*).

Hotchpot is an instance of the guarantor's right to the benefit of security taken in relation to the guaranteed obligation. It is a remedy exercised (in the first instance) against co-guarantors, and concerns security (commonly called "counter-security") that a co-guarantor has taken from the principal debtor to secure the principal debtor's obligation to indemnify the co-guarantor. Since, absent contrary agreement, all co-guarantors are entitled to equal treatment, the law treats the security as being held for the equal benefit of all co-guarantors. If it were otherwise, the principal debtor's estate would be reduced by the realisation of a security which would benefit only one of the co-guarantors.

Accordingly, hotchpot is the doctrine that a guarantor who obtains a counter-security from the principal debtor to which the guarantor may look for indemnification should it be called upon to pay under the guarantee, is obliged to hold that counter-security for the benefit of its co-guarantors (see Andrews & Millett at *paragraph 12-017*; *Steel v Dixon (1881) 17 Ch. D. 825*; *Berridge v Berridge (1890) 44 Ch. D. 168*).

A co-guarantor is obliged to bring its counter-securities into hotchpot even if it became a guarantor only on condition that it would obtain counter-security, and even if the other co-guarantors had no knowledge of the counter-security when they became guarantors. Co-guarantors may contract amongst themselves to dispense with the remedy of hotchpot, see *Steel v Dixon (1881) 17 Ch. D. 825*, at paragraph 832. A contract between the principal debtor and a single co-guarantor will not be capable of excluding hotchpot between co-guarantors.

It is worth noting that the principle of hotchpot only applies to securities given to the co-guarantor by the principal debtor. If a co-guarantor is given securities or benefits by a third party, these securities or benefits do not have to be brought into hotchpot: they never formed part of the principal's estate, and could never have benefited the co-guarantors in the first place.

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It is also worth noting that the principle of hotchpot applies to securities which a co-guarantor obtains by subrogation. In other words, if a co-guarantor pays off the guaranteed debt and thereby obtains the benefit of securities previously held by the lender, those securities must be brought into hotchpot for the benefit of all the co-guarantors.

Quia timet relief

A guarantor is in principle entitled to compel their co-guarantors to contribute towards the discharge of the shared debt even before that guarantor makes payment to the lender. It appears that there is no restriction upon the time at which a guarantor can apply for relief against their co-guarantors. The precondition to such a claim for *quia timet* relief is that the account between the lender and the principal debtor should be closed, and there should be an immediate liability due and payable under the guarantee with the result that the amount of the contribution can be precisely ascertained. It is not necessary for the lender to have demanded payment from the guarantor; it is sufficient that the lender could enforce the guarantee, either immediately or after making a demand, for more than the guarantor's rateable share (see further, Andrews & Millett at *paragraph 12-003* and *Stimpson v Smith [1999] Ch 340*).

A guarantor is only entitled to *quia timet* relief against their co-guarantors if the guarantor would have a right to contribution against those co-guarantors upon paying more than a rateable share of the common debt. Consequently, if the right to contribution is excluded, waived or lost, so is the right to *quia timet* relief. Further, a right to *quia timet* relief against co-guarantors (just like a right to contribution against co-guarantors) is only available if the principal debtor is insolvent or otherwise not worth suing; if the principal debtor can pay, then it is the principal debtor and not the co-guarantors who should bear the burden.

For the type of order that a Court may make on an application for *quia timet* relief, see Andrews & Millett at *paragraph 12-003* and *Wolmershausen v Gullick [1893] 2 Ch 514*, at paragraph 529. In that case, Wright J held that if the lender was a party to the proceedings then the Court could order the co-guarantor to pay its share to the lender; but that, where the lender was not party to the proceedings, the appropriate order was a declaration of the plaintiff's right to contribution, and an order that upon the claimant paying her own share, the defendant should indemnify her against any further payment or liability. It will normally be appropriate for the lender to be made a party to the proceedings.

WHAT DEFENCES ARE THERE AGAINST THESE RIGHTS?

The defences available to a co-guarantor facing a contribution claim can usefully be divided into four categories:

- Failure by the claimant to satisfy the preconditions of a contribution claim.
- Exclusion or waiver of the right of contribution as between co-guarantors.
- Full or partial discharge of the defendant as a result of release or indulgence granted to the principal debtor or another guarantor.
- Fraud or some other cross-claim against the claimant.

Although in theory it could be possible for a defendant to advance a defence recognised in the general law of unjust enrichment (for example, "change of position" or "impossibility of counter-restitution"), in practice there is likely to be little or no scope for raising such a defence, and there do not appear to be any reported examples of a defendant successfully doing so.

First, then, the defendant may show that the claimant has failed to make out the necessary elements of a valid contribution claim. The main ways of doing so are shown in *Claimant's failure to establish right to contribution*.

Second, the defendant may show that the right to contribution between co-guarantors has been excluded by the terms of the guarantee or by separate express agreement between the co-guarantors. An agreement

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CLAIMANT'S FAILURE TO ESTABLISH RIGHT TO CONTRIBUTION

- The defendant and the claimant are not guarantors of the same debt. (For example, they may instead have guaranteed different and distinct tranches of the same debt due from the principal debtor.)
- The defendant is in fact a sub-guarantor rather than a co-guarantor.
- The claimant has not paid more than its rateable share of the common debt; or the defendant has paid its rateable share.
- The claimant's payment of the guaranteed debt was not paid pursuant to any legal obligation, but was instead premature or officious: for example, because the claimant had and should have raised a valid defence to the lender's claim, or should have settled it on better terms. (The availability of this defence is limited by *section 1(4)* of the Civil Liability (Contribution) Act 1978 where the contribution claim is brought under that Act.)
- The defendant's liability in respect of the debt paid by the claimant has not yet arisen (for example, because the creditor has accelerated the claimant's obligation to pay but not the defendant's).
- The defendant's liability has been expressly excluded or waived by the lender.
- The claimant's contribution claim is time-barred.
- The claimant has failed to show that the principal debtor is not worth suing. A guarantor who wishes to bring a contribution claim against its co-guarantors must either prove that the principal is insolvent (or otherwise not worth suing) or join the principal debtor to the proceedings, see *Hay v Carter [1935] Ch 397*.

(Note that there is probably no defence where the defendant has a counterclaim or right of set-off against the lender (see Andrews & Millett at *paragraph 12-020*, and also at *paragraphs 11-007* and *11-012*.))

between the claimant and the defendant that the claimant would indemnify the defendant against any liability to which it might be exposed as a result of giving the guarantee operates to exclude the claimant's right of contribution, see Andrews & Millett at *paragraph 12-012*, citing *Rae v Rae (1857) 6 I. Ch. R. 490*.

Third, the defendant may raise a defence based on the conduct either of the lender or of the claimant guarantor. Since the basis of a claim for contribution is that the claimant co-guarantor has paid money which the co-surety could have been compelled to pay by the lender, if the defendant co-guarantor can show that the lender's (or the claimant's) conduct had released that co-guarantor from liability under the guarantee (in full or in part) by the time of the claimant's payment, the defendant will have a defence to that extent. Note that if the defendant was liable under the guarantee at the time of the claimant's payment, it is not necessarily a bar to a claim for contribution that the defendant has subsequently been released from liability. (Indeed, typically the defendant's liability to the lender will have been extinguished by the time of the claimant's contribution claim, precisely because the claimant has paid the principal debt.) See Chitty at *paragraph 17-027*: "The right of contribution is independent of any present right of the principal creditor. Thus one co-debtor can recover contribution from another although the principal creditor's right to recover from that other debtor has become statute-barred" (citing *Wolmershausen v Gullick [1893] 2 Ch 514*).

The general rules as to the discharge of guarantors on account of material variation of the guarantor's obligations therefore apply and may afford a defence to a contribution claim. The rules are covered in greater detail in *Practice Note, Variation of guaranteed obligations*, and the implications of those rules for contribution claims by co-guarantors are summarised in *Defences based on discharge of defendant co-guarantor*. See generally Andrews & Millett at *paragraphs 12-021 to 12-024*.

Finally, the defendant may be able to resist a claimant co-guarantor's claim for contribution by showing that the guarantor only assumed liability as a result of fraud by the claimant. Less spectacularly, and as previously stated, the defendant may be able to show that the guarantor only assumed liability under the guarantee in exchange for the claimant's promise to indemnify the defendant against any loss arising as a result; in such a

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DEFENCES BASED ON DISCHARGE OF DEFENDANT CO-GUARANTOR

- **Lender releasing principal debtor**: If the lender has given a release or indulgence to the principal debtor, any guarantors of the principal debtor's debt will be discharged (absent agreement to the contrary or a reservation of rights). Normally, this will preclude any claim for contribution arising in the first place. However, release of the principal debtor does not preclude a claim for contribution by a guarantor who has paid a part of the principal debt before the lender released the principal debtor, see Andrews & Millett at *paragraph 12-021*, citing *Reade v Lowndes (1857) 23 Beav 361*, at paragraph 368.
- **Lender giving additional time to the principal debtor**: Here too, any guarantors of the principal debtor's debt will be discharged, absent contrary agreement or a reservation of rights, see Andrews & Millett at *paragraph 9-029*.
- **Lender releasing one of a number of joint guarantors**: If the lender releases a guarantor from liability, the effect of this upon any co-guarantors depends on whether the co-guarantors' liability is joint or several. If the co-guarantors are jointly liable (or jointly and severally liable), then release of one will discharge the other co-guarantors. This is in line with the general principle that if a creditor releases one of a number of joint debtors, all of the joint debtors are released, see Chitty at *paragraph 17-017*.
- **Lender releasing one of a number of several guarantors**: Here, a co-guarantor (B) is released from liability under the guarantee only insofar as its security has been prejudiced by the lender having released the other co-guarantor (A) from liability. This is in line with the general principle that if a lender acts so as to diminish the value of the security held by a guarantor, the guarantor is discharged up to the value of the lost security, see *Skipton Building Society v Stott [2001] QB 261*.
- **Lender giving additional time to a co-guarantor**: A guarantor is not discharged from liability because the lender has given additional time to pay to the guarantor's co-guarantor. (It is different if the lender gives additional time to pay to the principal debtor.) The rationale is that while extending time to the principal debtor may increase the risk on the guarantor (and, theoretically at least, deprives the guarantor of its right to pay off the lender and sue the principal debtor in the lender's name), extending time to one guarantor cannot prejudice a co-guarantor.
- **Guarantor releasing principal debtor**: This situation would arise if a guarantor pays the principal debt, and is thereby entitled to sue the principal debtor for an indemnity, but releases the principal debtor. In this situation, the co-guarantors are released from the liability they would otherwise have had to pay contribution.
- **Guarantor giving additional time to principal debtor**: Again, this situation would arise in circumstances where the guarantor has paid the principal debt and become entitled to an indemnity from the principal debtor. Co-guarantors will be discharged, just as if it were the lender who had agreed to extend time to perform to the principal debtor, except for one difference: in order to be discharged, the co-guarantor must show that it has actually been prejudiced by the grant of additional time, see *Ward v National Bank of New Zealand (1883) L.R. 8 App. Cas. 755*.
- **Guarantor releasing a co-guarantor**: There is no direct authority on point, but it appears that the better view is that if one guarantor pays the principal debt and then releases one of a number of co-guarantors, the co-guarantors are discharged (on the same basis, and with the same effect, as release of a joint or several guarantor by a lender, as above).

case, there is no claim for contribution between the claimant and the defendant, since the relationship between the parties is one of guarantor and sub-guarantor rather than co-guarantors. Estoppel might also provide a defence.

CAN A CO-GUARANTOR WHO HAS PAID ITS SHARE BE RELEASED?

A co-guarantor's share of the principal debt is only known with certainty at the point at which the principal debt is paid in full. Until that point, there is a risk that one or more of the other co-guarantors will become insolvent, thereby increasing the share that the solvent co-guarantors will have to meet in the event of the principal debtor's default.

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The remedy of a co-guarantor who wishes to pay its share as it stands and be rid of the liability is to apply for *quia timet* relief (see, *Quia timet relief*), compelling that guarantor's co-guarantors to contribute towards discharge of the shared debt. This remedy is only available if there is a defined and ascertainable principal debt; and only if the right to contribution as between co-sureties has not been excluded by the terms of the guarantee or otherwise waived or lost. Further, a claim for *quia timet* relief against co-guarantors will only be available if the claimant can show that recourse against the principal debtor will be futile. If the principal debtor remains solvent then the co-guarantor's first remedy would be a claim for *quia timet* relief against the principal debtor, that is, for a declaration of the co-guarantor's right to be exonerated by the principal debtor and for an order that the principal debtor pay whatever is due to the lender, see Andrews & Millett at *paragraph 10-025*.

The more practical alternative is likely to be to negotiate an express release from the lender (who, if properly advised, will only agree to such release upon the express consent of the co-guarantors). The threat of a claim for *quia timet* relief may make consent from the co-guarantors more forthcoming.

CAN A CO-GUARANTOR TERMINATE A GUARANTEE?

There are two principal questions:

- When can a co-guarantor terminate a guarantee?
- What is the effect of such termination on the obligations of the remaining co-guarantors?

Termination in this context is a reference to stopping the guarantor's future obligations under a continuing guarantee. Even where such termination is possible, the guarantor is not thereby discharged from liability accrued prior to termination. The right of a guarantor to terminate its obligations under a guarantee is discussed in detail in *Practice Note, Guarantees: termination and discharge*.

The answers to these two questions depend on the terms of the guarantee. As to the first question, in general a co-guarantor is entitled to terminate a guarantee in the same circumstances as a sole guarantor would be able to. The only additional question arising is whether the guarantee expressly or impliedly provides that valid termination can only be given by all of the co-guarantors, such that purported termination by a single co-guarantor is ineffective. The presumption is that termination by a single co-guarantor is effective, and if the guarantee is to exclude that right it must do so clearly, see Andrews & Millett at *paragraph 8-011*, and compare the following cases:

- In *Egbert v National Crown Bank [1918] AC 903*, six guarantors jointly and severally guaranteed repayment of the liabilities of the principal debtor "until the undersigned, or the executor or administrator of the undersigned shall have given the bank notice in writing to make no further advances on the security of this guarantee". The Privy Council held that the guarantee remained in force against all of the guarantors until each of them (or their personal representatives) had given notice of termination.
- In *Kalil v Standard Bank of South Africa Ltd [1967] 4 S.A. 550*, co-guarantors signed a guarantee which provided that "this guarantee shall remain in force as a continuing guarantee ... until ... the bank shall have received notice from us terminating the same". The court held that an individual guarantor could validly give notice to terminate the continuing guarantee. The words "notice from us" did not mean that the notice had to be given by all the co-guarantors.

As to the second question, it has been submitted that, absent contrary wording in the guarantee, where one co-guarantor terminates a joint guarantee the remaining co-guarantors will be released from liability for future advances, see Andrews & Millett at *paragraph 8-013*. But the question has not yet been judicially determined, and a court could instead hold that the obligations of the remaining co-guarantors are wholly unaffected. It is highly unlikely that a court would hold that the unilateral termination by one co-guarantor of its future obligations under the guarantee could operate to discharge the co-guarantors altogether, though a guarantee could in principle be drafted to have this effect.

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WHAT HAPPENS IF A CO-GUARANTOR DIES OR IS MENTALLY INCAPACITATED?

If a guarantor dies or becomes mentally incapacitated, the personal representatives (or guarantor's estate) are in the same situation as regards the lender as the guarantor was in before that guarantor's death or incapacity. Death or mental incapacity of a guarantor does not, in and of itself, terminate the guarantor's obligations (though they become vested in the guarantor's personal representatives). Normally, the terms of the guarantee will provide that in order to put an end to the guarantor's prospective obligations under a continuing guarantee, the personal representatives must serve a termination notice, and it is not enough that the lender in fact becomes aware that the guarantor is dead or incapacitated, see *Re Silvester [1895] 1 Ch 573*, and compare *Coulthart v Clementson (1879-80) L.R. 5 Q.B.D. 42* and *Re Whelan, Dodd v Whelan [1897] 1 I.R. 575*.

Where there are co-guarantors, the question arises of whether the death or mental incapacity of a guarantor releases the personal representatives (or guarantor's estate) from their duty to pay contribution to a co-guarantor. The general answer is "no": the personal representatives (or guarantor's estate) remain liable.

The outcome might be different in the (unusual) situation where a co-guarantors were jointly (and not jointly and severally) liable for the guaranteed debt before one of them dies or becomes mentally incapacitated. The general rule with respect to joint liabilities is that death discharges a joint obligor from their liabilities. Accordingly, it might be expected that where such a joint co-guarantor dies or is incapacitated, their estate or personal representatives would not be compelled to contribute. In fact, the courts have in some cases been prepared to infer an implied contract that the estate would remain liable after death, in particular where the estate continues to enjoy a benefit from the guarantee. The cases in this somewhat rare and abstruse area are gathered at Andrews & Millett at *paragraph 12-026*, where they are described as "inconclusive". Most guarantees will provide that any co-guarantors' liability for the same debt is joint and several, with the result that this issue does not arise.

HOW DOES A CO-GUARANTOR ENFORCE ITS RIGHTS?

A guarantor suing its co-guarantors for contribution (or for *quia timet* relief) must join as defendants all those who are liable to make contribution, unless one of them is insolvent or there is some other good reason why that co-guarantor should not be joined, see *Hay v Carter [1935] Ch. 397*. This is so that the rights of all the parties can be determined in one inquiry, avoiding multiple and potentially inconsistent proceedings. Where one of the co-guarantors is bankrupt or has died or become mentally incapacitated, their trustee or personal representatives should be joined.

Unless the lender has already been paid and discharged by the claimant co-guarantor before the start of the contribution claim, the lender should also be made a party to the contribution claim. This is so that the court can order payment to the lender by the co-guarantors directly, thereby discharging the principal debt. If for any reason it is not possible for the lender to be joined to the proceedings, an alternative may be for the court to make a prospective order requiring the co-guarantors to pay contribution to the claimant if and when the claimant pays the lender.

If a guarantor is sued by the lender, that guarantor should bring Part 20 claims against the co-guarantors in the same proceedings rather than bringing separate contribution proceedings. Such a Part 20 claim should be brought even if the co-guarantors are already parties to the claim brought by the lender, see Andrews & Millett at *paragraph 12-018*.

As discussed above (see, *Contribution and the Civil Liability (Contribution) Act 1978*), it may not be clear in a particular case whether the guarantor's claim for contribution against its co-guarantors should be brought as a common law or equitable contribution claim or as a claim under *section 1* of the Civil Liability Act 1978. The practical solution is to claim both in the alternative.

If a guarantor pays the principal debt, intending subsequently to make recoveries against co-guarantors, that guarantor must take care not to prejudice those co-guarantors' rights against the principal debtor or against securities held in respect of the principal debt. If the guarantor fails to do this then the co-guarantors may have a full or partial defence to a contribution claim (see *What defences are there against these rights?*).

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HOW LONG IS THE LIMITATION PERIOD ON CLAIMS AGAINST CO-GUARANTORS?

The limitation period for a co-guarantor's contribution claim against its co-guarantors will depend on whether the claim is brought using the common law or equitable action, or instead under *section 1* of the Civil Liability Act 1978. (On this distinction generally, see *Contribution and the Civil Liability (Contribution) Act 1978*.)

- For a contribution claim using the common law or equitable action, the limitation period is six years, commencing on the date when the claimant has paid more than its rateable share of the common debt. This is in line with the general position for claims in unjust enrichment. See *section 5* of the Limitation Act 1980, and *Hampton v Minns [2002] 1 WLR 1* at paragraph 115.

- For claims brought under section 1 of the Civil Liability Act 1978, the limitation period is two years, commencing on the date on which the claimant's liability to the lender is determined by judgment, settlement agreement or admission, see *section 10* of the Limitation Act 1980.

There is thus a different limitation period, and a different date when time starts running for limitation purposes, depending on whether the co-guarantors' obligations to the lender sound in debt or in damages. This result is not easily defensible. Unless and until this unfortunate area of uncertainty is resolved by the courts, advisers of potential contribution claimants would be wise to assume that the limitation period for a contribution claim by one co-guarantor against another may be as short as two years.

However, from a practical point of view, where a lender makes a demand or brings a claim against a guarantor who knows or suspects that there may be other co-guarantors of the same primary debt, the guarantor will be best advised to bring contribution claims against the co-guarantors as Part 20 claims in the same proceedings, and may even initiate proceedings for *quia timet* relief against the co-guarantors before proceedings have been commenced against that guarantor by the lender (see, *Quia timet relief*). In the ordinary case, therefore, limitation should not arise as a problem.

Limitation is most likely to arise as an issue in a case where a guarantor does not realise that there are other co-guarantors for the same primary debt: that ignorance does not postpone commencement of the limitation period. The possible harshness of this situation may be mitigated by the fact that a guarantor who has paid the guaranteed debt is entitled to be subrogated to all of the lender's claims and securities in respect of the guaranteed debt. Indeed, this may circumvent the two year limitation period, since the guarantor who has paid the principal debt is (in principle) entitled to bring a subrogated claim in the lender's name against a co-guarantor provided that the limitation period that would have applied to the lender's claim has not expired. This point has not yet been tested by the courts, however, and a cautious approach to limitation is therefore warranted.

John Robb is a barrister at Essex Court Chambers.

USEFUL TEXTS

In addition to the texts referred to in this note, the following materials may be useful in further research:

- Gabriel Moss, QC and David Marks, QC, *Rowlatt on Principal and Surety* (Sweet & Maxwell, Sixth edition, 2011).
- Professor Hugh Beale, *Chitty on Contracts* (Sweet & Maxwell, thirty-second edition, 2015) Volume 2, Chapter 45 (Suretyship).

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