CATCHING THE SURETY

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Introduction

1. In troubled times, availability to a creditor of a guarantee of outstanding indebtedness is a valuable thing. The purpose of taking security in the first place is precisely so that if the debtor becomes unable to pay, the creditor has other effective recourse for the debt. Over the next year or two, one can expect to see creditors, whether they be landlords, developers or lenders, increasingly looking to sureties to make good defaults by their tenants, purchasers and borrowers.

2. But will the security prove to be effective? With an increase in the claims made against sureties or others who retain a contractual liability for the debts of others, lawyers for sureties will become increasingly adroit at taking points that, at least arguably (in order to stave off summary judgment), are a defence or a defence *pro tanto* to the creditor's claim. It happened in this way in the 1990s. One of the main arguments then relied on was that the surety had been released from his guarantee as a result of some dealing between the creditor and the debtor with reference to the obligations guaranteed but without the surety's consent, which it could not be said was obviously incapable of being detrimental to the surety's interests: the so-called rule in *Holme v Brunskill*[1].

3. These arguments will re-appear many times in 2009, 2010 and 2011 too, though as we shall see the drafting of guarantees has improved (from the creditor's point of view) so that the same arguments may not be as easy to run as they were 15 or more years ago. But there are bound to be some other arguments that will take their place. I shall look shortly at some of the issues that have arisen between the end of the last recession and the start of this – not necessarily in a property law context – and then look at how such arguments may be able to be deployed by sureties of tenants or purchasers to avoid liability. The surest way to catch the surety is to know in advance the arguments that he or she is likely to be able to deploy, or will try to deploy, and be able to pre-empt or avoid them.

4. But first it is necessary to return to some basics, in order to remind ourselves of the true nature of a surety's liability.

[1] (1878) LR 3 QBD 495.

Liability of surety

5. A guarantee, when reduced to basics, is a contractual undertaking (under seal or for valuable consideration moving from the promisee) that another person, the principal, will perform his obligations. These may be contractual obligations or debts.

6. In this basic form, the creditor's claim against the surety is a claim in damages, not a claim in debt. The surety is in breach of his contractual undertaking at the moment that the debtor fails to perform his obligation. This was only authoritatively decided by the House of Lords in 1972[2]. The surety is liable in damages for the loss that the creditor suffers that is caused by the non-performance of the debtor. In a case of non-payment of money, the loss is reasonably straightforward: the amount of money to be paid, interest and any costs expended in seeking to get the debtor to perform. In a more complex case such as failure to carry out a contractual obligation to build a development, the measure of damages will be more complex. But in all cases, with the basic form of guarantee, the claim is for damages, not in debt.

7. This is, of course, unwelcome to the creditor. If the surety is called upon to pay what the debtor should have paid but does not do so, the creditor has to bring a claim for unliquidated damages, which means that he cannot get judgment in default for a liquidated sum. Speed of recovery is often of paramount importance. As a result, lawyers started to draft guarantees in a more complex way, in particular by grafting onto the basic contractual undertaking a further promise that, in the event of default by the debtor, the surety would on demand pay to the creditor all such sums as were unpaid together with interest at a specified rate, or some other formulation to similar effect. This, arguably (it does not appear to have been challenged) gives the creditor a claim in debt against the surety, which can relatively easily be enforced by obtaining a money judgment in default, or upon a summary judgment application.

8. A further level of drafting sophistication saw addition to the words of guarantee of an undertaking in terms that the so-called surety was liable to the creditor by way of primary liability and not just as a guarantor of the debtor's obligations, and that the surety would indemnify the creditor against all losses, etc., incurred by the creditor in consequence of any non-performance by the debtor. Most commercial clauses drafted are very much more elaborate than this[3]. The purpose of this is, of course, to create an obligation of primary liability as between the creditor and the so-called surety and an obligation of indemnity that goes beyond the liability of a guarantor. The advantages of primary liability and an

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[2] *Moschi v. Lep Air Services* [1973] AC 331; *Hyundai Heavy Industries Co. v. Papadopoulos* [1980] 1 WLR 1129

[3] For the acme of all "guarantee" covenants, see the schedule to the judgment of Gloster J. in *Rayden v Edwardo Ltd.* [2008] EWHC 2689 (Comm).

indemnity are, first, that the formal requirements of section 4 of the Statute of Frauds 1677 do not apply to the extent that the contract is one of indemnity; and secondly that the traditional tenderness with which the courts of equity have treated a surety has not been applied in the same way to an indemnifier or a primary obligor. This means that some of the equitable defences available to a surety properly so-called, such as the rule in *Holme v Brunskill*, and some of the principles that can limit a surety's liability, such as the co-extensiveness principle, do not apply as such to someone who has assumed a primary liability or agreed to provide an indemnity.

9. You might wonder why, if this is right, a modern creditor, such as a bank, or an institutional landlord, bother with the taking of mere guarantees when they will be better protected by taking a joint and several or even a several promise from the director of the borrower or tenant to the same effect as the obligation undertaken by the borrower or tenant itself, or at least an indemnity covenant from a so-called surety. There answer to this is probably two-fold. First, by and large, the security that banks and institutional landlords take *is* drafted in a much broader way than it used to be, and does often amount to principal obligations and/or indemnities. Although this is nothing new since the recession of the 1990s, it has probably become even more widespread, and the drafting has become even broader, than it was before that recession.[4] In good times, when covenants of guarantee and indemnity are readily given, banks and institutional landlords pretty much get what they ask for. A lot of guarantees in modern form will have been given during the "boom" years of 1997-2007. This is another example of why traditional surety defences will be harder to run in this recession than they were in the 1990s[5]. Secondly, to the extent that banks and institutional landlords cannot simply dictate what form of security they require for a loan or a lease, a guarantee is traditional and understood, whereas multi-layering of principal obligations is less acceptable, at least to small businessmen and tenants. Whatever folly may be involved in taking out a fountain pen and signing a guarantee, it is a practice that is generally accepted and understood.

Construction

10. The first issue in any case where a claim is to be made against a "surety" is therefore to decide what the surety covenants mean, and to identify the nature of the claim that is to be brought against the surety. Rather like the distinction between a licence and a tenancy, the difference

[4] In apparent recognition of this, section 16 of the Landlord and Tenant (Covenants) Act 1995 permits an AGA to "impose on the tenant any liability as sole or principal debtor in respect of any obligation owed by the assignee under the relevant covenant".

[5] See *Rayden v. Edwardo Ltd*, above. In that case, the ample drafting of the guarantee left the sureties liable to pay £3.2million even though the principal had an arguable defence pro tanto by virtue of the mandatory insolvency set-off of a claim for misrepresentation against the creditor.

between a guarantee on the one hand and a primary obligation or indemnity on the other is one of substance and not mere language. If the substance of the contract recognises that there is another person who is primarily liable to the creditor, and that the surety's liability is dependent on default by that person, the contract is in substance one of guarantee, even if the phrase "as a principal debtor" appears in it[6]. Similarly, any indemnity that gives rise to a claim that is co-extensive with loss caused by a defaulting principal's breach of covenant will be a guarantee in substance[7]. In some cases, the right conclusion may be that there is both a covenant of guarantee and an indemnity, with the scope of each depending on the language of the particular contract.

11. In most cases, a claim to be brought against a surety will be a claim in debt or for an indemnity against losses suffered. If there is a sustainable case for a claim under a covenant of indemnity, or under a several or joint and several primary obligation, it is as well to make that plain at the outset, for then certain defences open to a surety properly so-called will not be available to the defendant. If a preliminary issue on the true construction of the contract is decided in favour of a primary obligation, there will be no need for a prolonged factual inquiry into the dealings between creditor and debtor after the so-called guarantee was made.

12. I deal later with particular issues that arise where the claim is brought against one of two or more persons jointly and severally liable, or severally liable, as principal obligors. But assuming that the conclusion reached is that the surety's obligation is only one of guarantee, what defences will the surety be able to raise to a liquidated claim made against him?

Defences of surety

13. Most of these defences are familiar and well-known. These include that the guarantee is not evidenced in writing and signed by the surety, a requirement of section 4 of the Statute of Frauds 1677. This requirement does not apply to an indemnity or to an obligation that imposes a primary liability. As we shall see, if the effect of a purported variation of the contract guaranteed is in reality to create a new contract, by way of novation or substitution, rather than a permitted variation of the existing contract, the surety will not be liable under the new contract unless his agreement is evidenced in writing and signed by him. An informal consent to a variation, such as is required under the rule in

[6] Note, however, the readiness of Moore Bick LJ in the Wittmann case discussed below to assume that the phrase "as primary obligor" was effective to oust the rule in *Holme v Brunskill*.

[7] See, e.g., *Stadium Finance Co v Helm* (1965) 109 SJ 471.

Holme v Brunskill, will not suffice to make the surety liable in relation to the new contract.[8]

14. Another well-known defence is that there is no binding contract of guarantee because there is no consideration given for the surety's promise. If the guarantee is under seal, consideration is supplied *ipso facto*; but if under hand only, there must be consideration (which is not past consideration) moving from the creditor for the surety's promise. That does not mean that the surety must receive consideration himself: the law requires consideration to move *from* the promisee, not *to* the promisor. Accordingly, as is commonplace, the grant of a lease to the debtor in consideration of the surety's guarantee is good consideration. But if the lease has already been granted and the surety signs a free-standing guarantee at a later date, there will not be consideration for the guarantee, unless of course the lease was agreed to be conditional on the making of the guarantee, in which case the consideration is the lease taking effect on discharge of the condition. With the relaxation under the Companies Act 2006 of the formal requirements for execution of contracts and deeds by or on behalf of limited companies, this is a point that needs to be watched. If there is no deed, there may be no consideration for the guarantee.

15. Coming back to the rule in *Holme v Brunskill*, it is hereabouts (in relation to surety covenants) that most activity in the courts has been focussed since the last recession. The rule is to the following effect: any variation in the terms of the contract guaranteed which *could* prejudice the surety and which is made without the surety's consent will discharge him from liability. On the facts of that case, the surrender of part of a farm potentially affected the ability of the lessee to deliver up a flock of sheep in good condition at the end of the lease, and so the surety was discharged. It is a strict rule, in that if it is not without enquiry clear at the time that the surety's interests cannot be affected prejudicially, the surety is released whether or not the variation *in fact* prejudiced him.

16. But the rule is confined to variations of the contract between the debtor and the creditor. Thus, in *Metropolitan Properties Co. (Regis) Ltd. v. Bartholomew*[9], a variation of the terms of the tenancy binding for the future as between the landlord and an assignee of the term did not discharge a surety for the original lessee, whose obligations were not affected by the variation agreed with the assignee. In this regard, a difficult issue is whether or not some other dealing between the creditor and the debtor, which does not as such vary the contract guaranteed, is within the rule. Suppose, for example, a bank loan in a given amount is guaranteed, and the following year the borrower takes out another loan from the same bank to fund another project, with which the surety has no

[8] *Wittmann (UK) Ltd. v. Willdav Engineering S.A.* [2007] EWCA Civ 824, per Buxton LJ.
[9] [1996] 1 EGLR 92.

connection. The existing contract of loan is unaffected, and yet the borrowing of further monies in connection with another project must increase the risk of the borrower defaulting on the loan guaranteed by the surety.

17. The better view is that such a dealing does not fall within the rule unless it is at variance with the terms of the contract guaranteed, even though it is something agreed between creditor and debtor that increases the surety's risk.[10] The reason is that, absent some agreed limitation, the surety has taken this risk, whereas he has not taken the risk of the contract guaranteed becoming more onerous in itself. If the surety wants to be protected against some other unconnected dealing, he needs a term of the contract to that effect.[11] In practice, the question may arise slightly differently, in that very often the terms of the contract guaranteed, particularly loans, do make provision for further advances or for consolidation or re-scheduling of loans. In those circumstances, the question is whether or not what happened subsequently was either specifically within the terms of the contract guaranteed, or at least was a variation of that contract to which the surety has in general terms given his consent in advance.

18. The old example of an agreement to give the debtor extra time to pay[12] is best regarded as falling within the principle of the rule in *Holme v Brunskill* rather than as being *sui generis*. The giving of time increases the risk to the surety of the debtor being able to perform and delays the surety's right to pay off the creditor and then seek to recover from the debtor by way of indemnity. However, guarantees have for at least a century routinely included a clause to the effect that the guarantee is not affected by any time given by the creditor to the debtor to pay. Much more recent (notwithstanding the relative antiquity of the rule in *Holme v Brunskill*) is the inclusion of a clause of the following kind: "no variation of the contract shall affect the validity of the guarantee hereby given", or, more broadly, "this guarantee shall remain in force notwithstanding the happening of any event that would otherwise have released the surety". One real example, taken from the *Wittmann v. Willdav*[13] case, is:

"The Guarantor shall not be discharged by time or any other concessions given to the Company .. or by anything Wittmann may do or omit to do, or by any other dealing or thing which, but for this provision, would or might discharge the Guarantor."[14]

[10] See *National Westminster Bank plc v Riley* [1986] BCLC 268, 275-6 and dicta in *Moat Financial Services v Wilkinson* [2005] EWCA Civ 1253 at para. 11.
[11] In *Lloyds TSB Bank v Hayward* [2005] EWCA Civ 466, a creditor agreed with the surety that he would not exercise the variation right that the contract gave him without the consent of the surety. The effect was to "reinstate" the rule in *Holme v Brunskill* notwithstanding the terms of the original guarantee.
[12] See, e.g., *Polak v. Everett* (1876) 1 QBD 669; *Mahant Singh v U Ban Yi* [1939] A.C. 601.
[13] n.8, above.
[14] And see the *Rayden v Edwardo* case, above, for a further level of sophistication and/or overkill in the drafting.

19. It is well established at common law that such an agreement, purporting to exclude an equitable defence to a future claim against the surety, is effective.[15] (The question of the extent to which the Unfair Terms in Consumer Contracts Regulations 1999 may invalidate such a provision, where they apply to the contract of guarantee, is a matter to which I return later.) At common law, if a surety can later consent to a variation of the contract guaranteed so as to preserve his existing liability, he can do so in advance, in the terms of the guarantee itself. But, self-evidently, everything depends on the terms used. To take the simple example given above, "no variation of the contract shall affect the validity of the guarantee hereby given", the consent is clearly to all variations of the contract that may be made, and so the issue becomes one of whether what is later agreed is a variation of the terms of the original contract, or whether it is a new contract that the surety has not guaranteed.

20. In *Tridos Bank N.V. v. Dobbs*, Mr Dobbs guaranteed to the bank that all monies owing or incurred by the company "under or pursuant to the Loan Agreement" would be paid on demand, up to a maximum liability for him of £50,000. The guarantee provided that the bank might at any time, without reference to Mr Dobbs, agree to any amendment, variation, waiver or release in respect of an obligation of the company under the loan agreement. There was express provision for re-scheduling the repayments in the event of a partial re-payment. The bank first re-scheduled the debts of the company in a new loan agreement and then made a further new agreement, which included the outstanding balance but also increased the facility to cover a further development project.

21. Longmore LJ said that anything that was properly called an amendment or variation was covered by the clause. This could include a new agreement that in form merely replaced the existing agreement, since the fact of a new agreement would then be a matter of form rather than of substance. But if the new agreement was a new agreement in substance, then the guarantee did not extend to it at all: sums due under the new agreement could not then be said to be payable "under or pursuant to" the existing agreement. As a matter of principle, he held that the test was whether or not the contract under which the principal was liable was a contract "within the general purview of the original guarantee". While recognising that this was not a test that enabled one to draw a hard and fast line between permissible and impermissible variations, the first new agreement was, despite its being formally a new agreement, held to be an

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[15] See *Triodos Bank N.V. v. Dobbs* [2005] EWCA Civ 630, paras 8, 9, 14, referring to the first edition of Rowlatt on the Law of Principal and Surety (1898).

amendment; but the second new agreement was not, being substantially different from the original loan agreement.

22. Chadwick LJ stated, first, that a surety is not to be taken to have agreed that his liability would be increased or made more onerous by a subsequent agreement between the parties unless there are clear words in the guarantee that show that he did agree to be bound in the future by a more onerous obligation imposed without further reference to him. There were clear words in the contract of guarantee exposing him to the risk arising from an amendment or variation of the obligations of the company under the first loan agreement, but not to increased risk arising from additional obligations of the company that were not properly to be treated as amendments or variations of the existing obligations.[16] So the question is: were the varied obligations "amendments or variations" of the original obligations within the meaning of those words in the contract. If the obligations of the company in the new loan agreement were not obligations under or pursuant to the original loan agreement, then Mr Dobbs was not liable. The new agreement clearly imposed obligations going beyond those of the original agreement, and it was not just a variation of the contract that Mr Dobbs had guaranteed.

23. A decision going the other way is *Wittmann (UK) Ltd v. Willdav Engineering S.A.*[17] In that case, Willdav guaranteed payment for parts delivered to its US subsidiary. Title to the parts only passed on full payment. The guarantee stated that it would not be discharged by any concession or other dealing or thing that would otherwise discharge the surety, and that the surety undertook liability "as primary obligor". The supply contract was later varied to allow a finance company to pay a reduced price for the parts, with title passing to it immediately, and with the residue of the original purchase price to be paid by the purchaser. The trial judge held that the new contract was of a different nature, which the surety had not guaranteed. But the majority of the Court of Appeal held that the only differences in the contract were that title passed immediately on payment by the finance house and that the purchaser was only liable to pay the residue rather than the full price. The majority agreed that the guarantee could not, on its true construction, apply to a different contract; but the contract with the purchaser remained, albeit for payment at a much lower price. That reduction in price could not prejudice the surety, so the only issue was that the supplier had given up further security, namely the retention of title, as part of the re-structuring of the deal. Moore Bick LJ held this variation did fall within the "permitted dealings" clause, and that in any event Willdav had contracted as primary obligor and so the equitable rule about release of other securities for performance did not apply.

[16] This was said in the context of a single new agreement that purported to cover all existing liability and of a cap on liability of £50,000. It does not purport to address the question of whether or not the making of a separate contract between the creditor and debtor sufficed to discharge the surety.
[17] Above.

24. If the effect of the variation or other dealing is to create a new principal agreement – so that there is no room for the anti-variation clause to preserve the liability of the surety (as in *Triodos Bank v Dobbs*) – then the question is whether or not the surety has agreed to guarantee the new agreement. As noted previously, this requires signed evidence in writing for the purposes of section 4 of the Statute of Frauds. In *Triodos*, Mr Dobbs had clearly not signed the new loan agreement as guarantor and so was not liable to guarantee the new loan agreement. But in *Moat Financial Services v Wilkinson*[18] it was held that the sureties had agreed to guarantee an additional loan of £150,000 as well as the original loan of £100,000. The sureties argued that they had only signed the new agreement to signify their consent to the variation of the contract that they had originally guaranteed. The Court of Appeal dismissed as "fanciful" the notion that the lender would lend more on an unsecured basis. The signature of the guarantors sufficed for section 4 purposes.

25. I said above that it is well established at common law that a clause in the guarantee giving consent in advance to future variations is lawful and can be effective. The Unfair Contract Terms Act 1977 does not generally apply to strike down clauses such as the "anti-discharge" clauses considered above: these are not exemption clauses within the meaning of section 13 of that Act. But the Unfair Terms in Consumer Contracts Regulations 1999[19] are of wider application. Provided that the surety is dealing with the creditor as a consumer and not in the course of his business, any term other than a core term that has not been individually negotiated with the surety, and which contrary to the requirement of good faith creates a significant imbalance between the parties' rights and obligations to the detriment of the surety,[20] will be unenforceable against the surety.[21] Despite one decision to the contrary, a director of the debtor company who gives a guarantee in the course of the company's business is probably not a consumer[22], and the same presumably goes for a partner who guarantees a partnership debt and a manager who guarantees the debt of a limited liability partnership. These points cannot, however, be regarded as authoritatively decided and one can expect them to be litigated over the course of the next few years.

26. Assuming that the view expressed above about company directors is right, the scope for the 1999 Regulations to strike down standard types of guarantee given to lenders in support of business lending is limited. But where the guarantee is not of this kind – e.g. an authorised guarantee agreement, or a guarantee given in support of personal

[18] [2005] EWCA Civ 1253.
[19] S.I. 1999 No. 2083.
[20] Reg. 5(1).
[21] A first instance decision to the contrary in the Mercantile Court in Manchester, *Governor and Company of the Bank of Scotland v Singh*, is widely considered to be wrong in holding that the Regulations cannot apply in a case where the surety is the consumer: see, e.g., Chitty on Contracts (30th ed), para. 44-140.
[22] Again, notwithstanding the decision in the *Bank of Scotland* case.

borrowing – there must be a very strong argument that the more extreme types of clause that have become commonplace in the sphere of business and commercial lending, straining to preserve the liability of the surety regardless of what happens after the guarantee is signed, will be held to be unenforceable.

27. To summarise where we are on the rule and the avoidance of the rule in *Holme v Brunskill*, therefore -

(1) If the course of dealing between the creditor and debtor creates a new contract or debt, different in substance from the one guaranteed, the surety is not liable in respect of that new contract unless he has agreed (complying with the section 4 formalities) to answer for it as guarantor.

(2) But if the new obligations do not displace the old, the surety will remain liable under the terms of the contract or debt that he has guaranteed unless the new dealing was made contrary to the terms of the guarantee.

(3) Where the course of dealing does amount to a variation of the existing obligations (regardless of the form that such variations take) rather than a new agreement in substance, the surety will be discharged unless the variation is self-evidently not detrimental to his interests or he has consented to the variation.

(4) Consent may be given in advance in the guarantee itself, specifically or generally, or at the time of the variation, but this consent does not need to satisfy the section 4 formalities[23].

(5) If consent is given in the guarantee, it is a question of construction of the words used whether the subsequent course of dealing falls within the category of dealings to which the surety has consented; and in this regard a test seems to be whether the obligations of the principal are "within the general purview of the original guarantee".

27. Given the prevalence of anti-discharge clauses in guarantees drafted during the last 15 years, not to mention the primary liability clauses, it is likely that creditors will have stronger arguments to resist a surety's defence that something done by the creditor and debtor since the date of the guarantee has discharged him. Most of the arguments will be about the true substance and effect of what it is that the creditor and

[23] For the reasons explained by Buxton LJ in *Wittmann v Willdav*, above, at para. 27.

debtor have done, and whether or not this is either beyond the general purview of the guarantee or outside the scope of variations permitted by the terms of the guarantee. One argument that was still being vigorously pursued at the time of the last recession, namely whether or not a surety is released upon a disclaimer of the tenant's interest in a lease, has now been settled on the highest authority. Disclaimer does not put an end to the surety's liability: the obligation of the tenant is deemed to continue for the purpose only of preserving the surety's liability.[24]

28. In a landlord and tenant context, there have of course been important changes since the end of the last recession to the law as it applies to sureties of tenants and former tenants. In relation to "new tenancies" within the meaning of the Landlord and Tenant (Covenants) Act 1995[25], the liability of the tenant under the tenant covenants of the lease ends on a lawful assignment of the lease (other than one that takes effect by operation of law).[26] Accordingly, the surety's liability ends then too.[27] It is not possible to contract out of these provisions.[28] The tenant may, however, be required to guarantee the performance of the tenant covenants by his assignee under an authorised guarantee agreement.[29] It is still not clearly established whether or not the assignor's guarantor can be required to guarantee his AGA, and if he does so whether he is bound by that guarantee.

29. Any claim against a surety of a former tenant (but not a surety of the current tenant) for rent, service charge or other liquidated sums under the lease is now dependent on written notice in prescribed form of the amount of the claim having been given to the surety within 6 months of the date on which the sum became payable.[30] This applies to new tenancies and old tenancies alike. Failure to give such a notice in time means that the surety is not liable even if the former tenant remains liable; and service of a section 17 notice can probably operate to preserve a claim against the surety even if the former tenant's liability disappears by virtue of that section.

30. In addition to the operation of the *Holme v Brunskill* principle, there is now a statutory limitation on the extent of the liability of a former tenant and a surety for a former tenant.[31] This operates where the monetary liability of such a person is increased by a variation of the lease made after the assignment by the former tenant. It only applies where the variation is one that the landlord had the right to refuse, or would have

[24] *Hindcastle Ltd. v Barbara Attenborough Associates Ltd.* [1997] A.C. 70.
[25] i.e. essentially those granted on or after January 1, 1996.
[26] Landlord and Tenant (Covenants) Act 1995, ss. 5(2), 11(1),(2).
[27] *Ibid.*, s.24(2).
[28] *Ibid.*, s.25.
[29] *Ibid.*, s.16.
[30] *Ibid.*, s.17(1),(3).
[31] *Ibid.*, s.18.

had the right to refuse if he had not previously varied the terms of the tenancy so that he could not refuse it. The former tenant or surety is only "released" from liability to the extent that the variation has increased his liability. So, unlike the *Holme v Brunskill* principle, this statutory provision does not really release the surety; it just prevents his liability being increased by voluntary changes to the tenancy made after an assignment. Of course, if the *Holme v Brunskill* principle applies, there will be no need to invoke it, but that principle does not apply in the case of a former tenant under an old tenancy. If that principle does not apply to release a surety (because either the surety consented to the variation, or the variation is self-evidently not prejudicial to the surety), then it is a little difficult to see how the statutory provision can apply. Can it have been intended that sureties would be able to avail themselves of the statutory defence even though they had agreed to the variation? I am unaware of any reported decision on the scope of this section.

Liability of co-obligors

31. Assuming that the surety turns out to be a co-obligor and not merely a surety, the creditor has an independent claim against him that is not vulnerable to equitable defences that avail a surety. The clearest example of this in the cases so far discussed is the liability of Willdav to Wittmann. Willdav "guaranteed" the purchase of parts in terms that made it liable "as primary obligor". Thus, having analysed the effect of the change in the nature of the contractual relations, Moore Bick L.J. was able to hold Willdav liable notwithstanding that the variation had resulted in Wittmann giving up another security that it held for the payment of the price, namely the retention of title in the parts. Had Willdav been a surety only, the giving up of other security for the same obligations would have released Willdav.

32. The co-obligor is of course only being pursued because the principal debtor cannot pay. If the debtor is wound up and its obligations under the contract are disclaimed, then the co-obligor is not released, for the reasons explained by Lord Nicholls of Birkenhead in the *Hindcastle* case. (The same result follows where the debtor is an individual who is discharged from bankruptcy.[32]) But what if, instead, the creditor compromises his claim and accepts a partial payment from the debtor; or if the debtor makes a voluntary arrangement with its creditors under the Insolvency Act? Can the creditor recover what it can from the debtor and then claim the rest from the co-obligor?

33. The short answer is: yes, provided that it is clear that the creditor is reserving the right to pursue the co-obligor. The jurisprudential route to the short answer was a long judicial excursus on the differences between a release and a covenant not to sue, and between debtors with joint liability,

[32] Insolvency Act 1986, s. 281(7).

joint and several liability, or merely several liability.[33] But the Court of Appeal has authoritatively re-stated the underlying principle, namely that it is always a question of construction of the agreement made between debtor and creditor whether or not the creditor is to be free to pursue a co-obligor. This is often put in terms of the creditor "reserving his right" to pursue others for the same debt, though those words do not have to be used. If the creditor makes it clear to the debtor that he intends to pursue the co-obligor, there is no equitable fraud on the debtor who is released from part or all of the claims against him only to be faced with a claim for a contribution or an indemnity by his co-obligor.

34. A reservation of rights may be implied and need not be expressed; and it can be implied, apparently, from the background leading up to the making of the agreement as well as from the terms of the agreement itself.[34] There is no reason in principle why the same approach should not apply to a case where the co-obligor is a surety properly so-called. The principle of co-extensiveness of liability is not infringed because the principal is only released from liability on terms that the surety's liability remains (the principal's liability then becomes an obligation to indemnify the surety). *Finley v Connell Associates*[35] was in fact a case of debtor and surety, in which the principle of implied reservation of rights was established.

35. On any basis, it seems that a composition with the tenant of premises will not amount to a release of his predecessors in title, who remain severally (though non-cumulatively) liable for the same obligations[36]. Whether or not a release of one surety on the basis that rights are reserved against other sureties will entitle those sureties to treat themselves as discharged has not yet been determined. But, in principle, they are not prejudiced by the release since their rights to claim a contribution are preserved; and so they ought not to be able to treat themselves as discharged. If, on the other hand, the creditor releases some other tangible security, against which the other sureties have no further recourse, then they clearly are prejudiced and so will be released absent some provision in the contract of guarantee that entitles the creditor to act in this way.

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[33] See *Deanplan Ltd. v. Mahmoud* [1993] Ch 151; *Watts v Lord Aldington* [1999] L&TR 578; *Johnson v Davies* [1999] Ch. 117; *Sun Life Assurance Society plc v. Tantofex (Engineers) Ltd.* [1999] L&TR 568.
[34] See *Watts v Lord Aldington*, above; *Finley v. Connell Associates* [1999] Lloyd's Rep PN 895; *Greene King plc v. Stanley* [2001] EWCA Civ 1966.
[35] Above.
[36] See the *Sun Life v. Tantofex* case, above.