

Standing surety in England and Wales: the sphinx of procedural protection

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Abstract: *This article evaluates the protection afforded to non-professional sureties in England and Wales. In particular, this analysis considers how specific measures of protection have been developed to protect sureties in this particular legal, social and economic context. More specifically, the article considers how the democratisation of credit, the decline in social welfare protection, the significance of judicial policy in consumer bankruptcy and the development of doctrinal principles and statutory protections regulating the surety contract interlink to shape the ‘sphinx’ of surety protection in England and Wales.*

I. INTRODUCTION

This article aims to unpack, map and evaluate the protection afforded to non-professional sureties in England and Wales. In particular, this analysis considers how specific measures of protection have been effectively developed, or not, to protect sureties in this particular legal, social and economic context. More specifically, the article considers how the democratisation of credit, the decline in social welfare protection, the significance of judicial policy in the context of consumer bankruptcy and the development of both doctrinal principles and statutory protections regulating the surety contract interlink to shape the landscape of surety protection in England and Wales.

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The Characteristics of Suretyship Transactions

At the outset it is useful to outline the essential characteristics of suretyships and the complex landscape in which they operate.¹ This is a delicate task for suretyships are frequently only precariously demarcated from other types of ‘guarantees’ and demarcation problems have generated both litigation and legislation. For example, as demand guarantees are held to be independent of the underlying principal contract, a demand guarantor cannot make use of all of the defences available to a surety. Yet the express words of a suretyship contract will also often exclude or restrict the operation of surety defences. This has led some to the view that the area is better characterised as an unstable spectrum of guarantees, with no general rule applicable to all guarantees and with the meaning of a particular agreement to be determined by the court on a case-by-case basis.²

The basic characteristics of the surety contract can be briefly summarised:

- The surety guarantees a sum/performance which the debtor/principal owes to the creditor;
- The agreement between surety and creditor is often unilateral;
- A suretyship is an agreement of *secondary* and *accessory liability*;
- The surety’s liability is *subsidiary* to the principal debtor’s duty to settle, and accessory to the liability and existence of the principal debt;
- The guarantor’s liability is *conditional and co-terminous*: if the principal’s liability is reduced, then the guarantor’s liability is reduced *pro tanto*;
- Traditionally the creditor owed no duty towards the surety.

In England and Wales there has been a consciousness that some sureties need protection.³ This is particularly so in the context of non-commercial suretyship transactions where:

¹ G. McCormack, Protection of Surety Guarantors in England – Prophylactics and Procedure in A. Colombi Ciacchi (ed.), *Protection of Non-Professional Sureties in Europe: Formal and Substantive Disparity*, (Baden Baden: Nomos, 2007) at 154.

² *ibid* at 154-155.

³ R. Parry, ‘The Position of Family Sureties within the Framework of Protection for Consumer Debtors in European Union Member States’ [2005] 13 ERPL 357, at 359; A. Colombi Ciacchi,

- There is often proximity between the surety and the principal debtor – for example through familial relations;
- The proximity between the surety and the principal may engender relational pressures;
- The surety would classically be in a weak position as regards the creditor;
- The suretyship transaction is typically not to the (direct) financial advantage of the surety.
- The surety runs a risk, which is, perhaps, greatest where a business loan is guaranteed.
- Where the potential liability involved is not in proportion to the surety's income and assets, this may lead to an indefinite obligation rebounding on the surety following the principal debtor's bankruptcy.

Mapping Surety Protection in England and Wales⁴

'Non-legislative Harmonisation of Private Law under the European Constitution: the Case of Unfair Suretyships,' [2005] 13 ERPL 297.

⁴ The idea of pursuing legal scholarship through the development of taxonomies is not without its critics: see, for example, D. Campbell, 'Classification and the Crisis of the Common Law' (1999) 26 *Journal of Law & Society* 369; P. Jaffey, 'Classification and Unjust Enrichment' (2004) 67 *Modern Law Review* 1012; G. Samuel, 'English Private Law: Old and New Thinking in the Taxonomical Debate' (2004) 24 *OJLS* 335. In the context of English property law, the activity of classification has become strongly associated with the Birksian taxonomy of private law, which, briefly stated, sought to identify a series of discrete categories into which legal rights, obligations, claims and outcomes would be 'mapped', to evaluate the 'rightness' of a decision by its ability to fit into the appropriate category, and to use the resulting taxonomy to direct the future development of the law along certain rational, clearly identified channels: see, for example, P. Birks, *English Private Law* (Oxford, Oxford University Press, 2000), pp. xxxv-xliii; P. Birks (ed) *The Classification of Obligations* (Oxford, Oxford University Press, 1997); P. Birks, 'Equity in the Modern Law', (1996) 26 *Western Australian Law Review* 1. In a recent paper Emily Sherwin analysed the role and function of legal taxonomies: see E. Sherwin, 'Legal Taxonomy' (Cornell Law School Legal Studies Research Paper Series, Paper 47, 2006); available online at <http://ssrn.com/abstract=925129>. Sherwin considered two competing models of legal taxonomy: (1) the 'reason based taxonomy' applied by Professor Birks, whereby legal rules and decisions are classified according to 'legal principles', and the resulting taxonomy is employed to determine future decision making, and (2) 'formal taxonomy', a process by which efforts are made to classify legal materials according to rules of order and clarity. Sherwin noted that while reason-based taxonomy seeks to identify 'high-level decisional rules', formal taxonomy 'serves less ambitious objectives, such as facilitating legal analysis and communication'. For formal taxonomy, the key objective of mapping legal provisions, principles or decisions was articulated by Sherwin as a based in a recognition that: '[c]lassification plays a necessary role in legal analysis: to think and argue clearly about law, we need to organize the raw material of legal rules and decisions into more general categories.'

Given the polycontextual⁵ nature of suretyship transactions the cartography of surety protection is complex. Surety protection in England and Wales is bifurcated: while contract law provides some measure of protection for sureties in certain circumstances, these protections are posed against a backdrop of low social welfare protection, and – despite legislative provisions which have sought to redress the balance – a strong pro-creditor bias in judicial approaches to property law provisions concerning creditor and debt, and in insolvency law. These contextual factors have important implications for the overall level of surety protection in England and Wales.

II. PROTECTION AFFORDED BY THE LAW OF CONTRACT

Regulation of the Contracting Process

It is axiomatic that the law of England and Wales does not recognise a generalised duty of good faith.⁶ Nevertheless the contracting process is regulated through the vitiating factors which will be illuminated in this section.

Improper Pressure

In recent years, a not uncommon complaint from sureties has been that the transaction was procured by improper pressure.⁷ In the context of non-professional suretyship transactions, improper pressure claims seem largely to be channelled through the doctrine of undue influence⁸ and this would seem to be a reflection on both the fact that undue influence is a wider doctrine than duress and it is more adept at dealing with the more surreptitious types of pressure which may arise in a relational context. Yet the doctrine of undue influence is elusive and there is vigorous debate about the jurisprudential basis of the doctrine. In particular, Professors Birks and Chin argued that undue influence is about impaired consent and that “it is not necessary for the

⁵ M. Kenny, ‘Standing Surety in Europe: Common Core or Tower of Babel’ (2007) 70 MLR 175 at 180-183. G. Teubner, ‘In the Blind Spot: The Hybridization of Contracting’ (2007) 8 Theoretical Inquiries in Law: <http://www.bepress.com/til/default/vol8/iss1/art4> at 11; G. Teubner, ‘Das Recht hybrider Netzwerke’ (2001) 165 ZHR 550; ‘Hybrid laws: Constitutionalizing Private Governance Networks,’ in R. Kagan et al. (eds.), *Legality and Community: On the Intellectual Legacy of Philip Selznick*, (Berkeley: Berkeley Public Policy Press, 2002) 311-331.

⁶ *Interfoto Picture Library Ltd v. Stiletto Visual Programmes Ltd* [1989] 1 QB 433 at 439.

⁷ M. Pawlowski & J. Brown, *Undue Influence and the Family Home* (London: Cavendish, 2001).

⁸ B. Fehlbeg, *Sexually Transmitted Debt* (Oxford: Clarendon, 1997).

party claiming relief to point to fraud or unconscionable behaviour on the part of the other.”⁹ By contrast, one of the current authors has argued that undue influence is based on a notion of unconscionability with clear parallels to the unconscionable bargain doctrine,¹⁰ which will be discussed later in this paper.

Whatever the true jurisprudential basis of undue influence might be, it is clear that the most common role of the doctrine is to regulate pressure in personal relationships. Such relationships may¹¹ or may not¹² be familial in nature. Although undue influence may take many forms,¹³ it is possible to identify familiar situations. At one end of the spectrum are cases where a pre-existing relationship makes one person more susceptible to pressure from the other¹⁴ or where the pressure would not be objectionable outside of a personal relationship.¹⁵ At the other end of the spectrum are cases where one person defers their will to another.¹⁶ The centre ground is occupied by a myriad of situations where there is no “routine dependence or submissiveness...”¹⁷ nor “unpleasantness”¹⁸ but the complainant can show that: “...(a) the other party to the transaction... had the capacity to influence the complainant; (b) the influence was exercised; (c) its exercise was undue; (d) its exercise brought about the transaction.”¹⁹

For many years it has been customary to make a distinction between actual undue influence and presumed undue influence. Actual undue influence referred to situations where the complainant could affirmatively prove undue influence,²⁰ and, as such, it might be expected that the mainstay of actual undue influence would be cases concerning acts of (improper) overt pressure. The concept of presumed undue influence is much more mysterious, not least because the nature and rationale(s)

⁹ P. Birks & N.Y. Chin, “On the Nature of Undue Influence” in J. Beatson & D.F. Friedmann (eds.), *Good Faith and Fault in Contract Law*, (Oxford: Clarendon, 1995) at 126.

¹⁰ J. Devenney & A. Chandler, ‘Unconscionability and the Taxonomy of Undue Influence’ [2007] JBL 541.

¹¹ *Bainbridge v. Browne* (1881) Ch. D 188 and *Barclays Bank plc v. O’Brien* [1994] 1 AC 180.

¹² *Allcard v. Skinner* (1887) 36 Ch. D 145, *Avon Finance v. Bridger* [1985] 2 All ER 281 and *Crédit Lyonnais Bank Nederland NV v. Burch* [1997] 1 All ER 144.

¹³ *Allcard v. Skinner* (1887) 36 Ch D 145 at 183 *per* Lindley LJ.

¹⁴ *cf* *Wingrove v. Wingrove* 11 P. D. 81 and *Hampson v. Guy* 64 L.T. 778.

¹⁵ *CTN Cash & Carry Ltd v. Gallagher* [1994] 4 All ER 714 at 719d *per* Steyn LJ.

¹⁶ *Bank of Montreal v. Stuart* [1911] AC 120.

¹⁷ P. Birks & N.Y. Chin, above n 9 at 78.

¹⁸ *ibid.*

¹⁹ *Bank of Credit & Commerce International S.A. v. Aboody* [1990] 1 QB 923 at 963.

²⁰ *Barclays Bank v. O’Brien* [1994] 1 AC 180 at 196.

behind the presumption, if indeed it is a true presumption, is far from clear. In the light of *Barclays Bank v. O'Brien* it seemed that undue influence would be presumed where (a) there was a relationship of trust and confidence between the parties,²¹ and (b) the parties entered into a transaction which was manifestly disadvantageous to the complainant. As regards the former requirement, there were some relationships which, as a matter of law, were deemed to be relationships of trust and confidence, thus reducing the difficulty of establishing a presumption of undue influence. Such relationships, known as 2A relationships, included the relationship between a parent and an unemancipated child,²² and the relationship between a medical advisor and advisee.²³ It did not include the relationship between a husband and a wife²⁴ which, in common with other relationships not coming within 2A, had to be shown to be a relationship of trust and confidence in each individual case (a so-called 2B relationship).

The notion of a manifestly disadvantageous transaction has been particularly problematic in the context of suretyship transactions,²⁵ and in *Barclays Bank plc v. Coleman*²⁶ Nourse LJ questioned whether such a requirement should be removed.²⁷ Take, for example, the stereotypical case where a wife agrees to act as surety for her husband's business debts. Is such a transaction manifestly disadvantageous to the wife? In one, perhaps narrow, sense the answer must be affirmative; the wife is guaranteeing the debts of another, often without direct benefit. Yet, in another, wider sense the wife may be getting a very real indirect benefit if the fortunes of the husband and wife are intertwined. The difficulties are amplified where, for example, the wife has a shareholding in the business which the husband runs.²⁸

In *Royal Bank of Scotland v. Etridge*²⁹ the House of Lords had an opportunity to grapple with some of the issues surrounding the so-called presumption of undue

²¹ cf *Re Craig (decd)* [1970] 2 All ER 390.

²² *Bainbridge v. Browne* (1881) Ch. D 188.

²³ *Huguenin v. Baseley* (1807) 14 Ves. 273.

²⁴ *Barclays Bank v. O'Brien* [1994] 1 AC 180.

²⁵ B. Fehlbeg, 'The Husband, the Bank, the Wife and Her Signature – the Sequel' (1996) 59 MLR 675, 677.

²⁶ [2000] 1 All ER 385.

²⁷ *ibid* at 397-399.

²⁸ B. Fehlbeg, *supra* at n 25.

²⁹ [2001] UKHL 44; [2002] 2 AC 773; [2002] 1 Lloyd's Rep 343..

influence. In that case Lord Nicholls³⁰ painted the so-called presumption of undue influence in terms of an *inference* of undue influence; the complainant establishes a *prima facie* case of undue influence, which transfers the evidential burden to the other party to dissuade the Court from making an inference of undue influence. On such an analysis, the *precise* nature of the relationship between the parties as well as the transaction is crucial. Yet, surprisingly in the light of this approach, none of Their Lordships really engaged with the question of why some relationships, formerly referred to as 2A relationships, are automatically deemed to be relationships of trust and confidence. As regards the requirement that the transaction had to be manifestly disadvantageous to the complainant, Lord Nicholls felt that the phrase ‘manifest disadvantage’ was apt to mislead. Therefore for the future the relevant requirement would be whether the transaction, failing proof to the contrary, was only explicable on the basis of undue influence.³¹ Significantly, in the context of the stereotypical case outlined above, Lord Nicholls did not think that a wife acting as surety for her husband’s debts would *normally* satisfy this requirement.³²

Where a suretyship transaction has been procured by the undue influence of the *creditor*, the surety will, subject to certain bars, be entitled to have that transaction set aside. By contrast, where the suretyship transaction has been procured by the undue influence of the *debtor* the position is more complex. In such cases the courts must balance both the interests of the surety and the creditor in the light of any public interest.³³ Prior to the landmark decision of the House of Lords in *Barclays Bank plc v. O’Brien*³⁴ there was some confusion as to the vehicle that would be employed to balance these interests. Since that decision, however, it has been clear that an innovative, if unconventional, use of the doctrine of notice was the chosen vehicle. Henceforth, where a suretyship transaction had been procured by undue influence of the *debtor*, the surety would, subject to certain bars, only be entitled to have that transaction set aside if the creditor either had actual or constructive notice of the debtor’s misconduct.

³⁰ *ibid* at [16].

³¹ [2001] UKHL 44 at [29].

³² [2001] UKHL 44 at [30].

³³ [2001] UKHL 44 at [34]-[37].

³⁴ [1994] 1 AC 180.

Constructive notice refers to situations where a creditor is *deemed* to have notice of the debtor's misconduct by virtue of a failure to take certain steps, whether or not the creditor has actual knowledge of the debtor's misconduct. A creditor will be required to take certain steps in this context if they have been 'put on notice'. In *O'Brien* Lord Browne-Wilkinson stated:

“...in my judgment a creditor is put on inquiry when a wife offers to stand surety for her husband's debts by the combination of two factors: (a) the transaction is on its face not to the financial advantage of the wife; and (b) there is a substantial risk in transactions of that kind that, in procuring the wife to act as surety, the husband has committed a legal or equitable wrong that entitles the wife to set aside the transaction.”³⁵

Subsequently there was some debate both as to whether the creditor was only put on notice where it, for example, knew that the relationship between the husband and wife was one of trust and confidence, and how to apply this test to other types of relationship. Thereafter the principle was refined in *Etridge* where Lord Nicholls held that a creditor is always put on enquiry where the relationship between the debtor and the surety is non-commercial and this is known to the bank.

Once the creditor is put on enquiry, it must take steps to minimise the risk of undue influence. Failure to take appropriate steps saddles the creditor with constructive notice of any undue influence. Again the House of Lords went on to elaborate the position of creditors in *Etridge*. In particular, Their Lordships laid down a procedure for future surety transactions, requiring that creditors obtain from the surety's solicitor confirmation that the surety had understood the documentation. The creditor was obliged to supply the surety's solicitor with information on the underlying loan and the principal debtor's indebtedness to enable the solicitor to advise the surety.³⁶ Specific criteria, 'core minimum requirements' applying to both creditors and their legal advisers in all non-business third-party security cases have thus been elaborated

³⁵ *ibid* at 196.

³⁶ *ibid* Lord Nicholls at para 79; D. Morris, 'Surety Wives in the House of Lords: Time for Solicitors to 'Get Real'?' (2003) 11 Feminist LS 57.

from *Etridge*.³⁷ The Law Society has issued guidelines for solicitors on the basis of these core minimum requirements, including a draft letter to the spouse standing surety. These guidelines are available on the Law Society's website.³⁸

Informational Problems: Misrepresentation and Non-Disclosure

Contracts of suretyship are not contracts *uberrimae fidei*³⁹ and, therefore, the creditor is not under a duty of *full* disclosure.⁴⁰ Nevertheless, there may be two situations where a creditor is under a duty of disclosure, albeit a limited one. First, there is a growing body of case law which recognises that a creditor may be under a duty to disclose unusual features of the transactions.⁴¹ The ambit and implications of this limited duty are still being worked through.⁴² Secondly, there may be situations where non-disclosure contributes to an implied misrepresentation.⁴³

Where a creditor has induced⁴⁴ the surety to enter into the suretyship transaction by an express or implied misrepresentation, the surety may, subject to certain bars, have the transaction set aside.⁴⁵ By contrast, where the suretyship transaction has been procured by the misrepresentation of the *debtor* the suretyship transaction will only be set aside if the creditor had notice under the *O'Brien/Etridge* principles.

³⁷ *Royal Bank of Scotland v. Etridge (No.2)* [2002] 2 AC 773. Lord Nicholls [57]: 'if the bank knows that the solicitor has not duly advised the wife or ... if (it) knows facts from which it ought to have realised that the wife has not received the appropriate advice ... the bank will proceed at its own risk.' See, generally, E. Peel (ed.), *Treitel: The Law of Contract* (12th edn., London, Sweet & Maxwell, 2007) pp.460-463.

³⁸ Undue Influence: Solicitors' duties post *Etridge*, Law Society, May 2002: <http://www.lawsociety.org.uk/secure/file/147269/d:/teamsite-deployed/documents//templatedata/Policy/Issued%20guidance/Documents/etridgeguidance1.pdf>. Additionally: <http://www.lawsociety.org.uk/secure/file/147270/d:/teamsite-deployed/documents//templatedata/Policy/Issued%20guidance/Documents/etridgeletter1.pdf>. Guidelines flanked by provisions on conflicts of interest in the *Solicitors' Practice Rules, 1990*.

³⁹ *Royal Bank of Scotland v. Etridge (no. 2)* [2001] UKHL 44 particularly [112] *per* Lord Hobhouse.

⁴⁰ *Hamilton v. Watson* (1845) XII Cl. & Fin. 108 and *The North British Insurance Co v. Lloyd* (1854) 10 Ex. 523. cf *Railton v. Matthews* (1844) 10 Cl. & Fin. 934.

⁴¹ *Levett v. Barclays Bank plc* [1995] 1 WLR 1260, *Crédit Lyonnais Bank Nederland v. Export Credit Guarantee Department* [1996] 1 Lloyd's Rep 200, and *Royal Bank of Scotland v. Etridge (no. 2)* [2001] UKHL 44.

⁴² *Royal Bank of Scotland v. Etridge (no. 2)* [2001] UKHL 44.at [81] *per* Lord Nicholls.

⁴³ *London General Omnibus Co Ltd v. Holloway* [1912] 2 KB 72 at 78.

⁴⁴ The misrepresentation does not need to be the sole or the main reason why the surety entered the transaction: see *Edginton v. Fitzmaurice* (1885) 29 Ch. D 459.

⁴⁵ The surety may also be able to claim damages: see J. Poole & J. Devenney, 'Reforming Damages for Misrepresentation: the Case for Coherent Aims and Principles' [2007] JBL 269.

Vulnerability: Questions of Capacity and Unconscionability

Suretyship transactions are, of course, subject to the normal contractual rules governing capacity.⁴⁶ In addition, a surety with particular vulnerabilities may receive some protection through the unconscionable bargain doctrine.⁴⁷ Although this doctrine is of respectable antiquity,⁴⁸ in modern times it has tended to lead an understated life in this jurisdiction.⁴⁹ A useful starting point is the judgment of Peter Millett QC in *Alec Lobb (Garages) Ltd v. Total Oil GB Ltd*.⁵⁰ In that case the learned judge stated:

“...if the cases are examined, it will be seen that three elements have almost invariably been present... First, one party has been at a serious disadvantage to the other... Secondly, this weakness of the one party has been exploited by the other in some morally culpable manner...And third, the resulting transaction has been... overreaching and oppressive. In short, there must... be some impropriety, both in the conduct of the stronger party and in the terms of the transaction itself...”⁵¹

A number of points need to be made in connection with this statement. First, it is clear that the unconscionable bargain doctrine is built upon the concept of a ‘special disadvantage’.⁵² In the past, “poverty and ignorance”,⁵³ necessity,⁵⁴ mental deficiency⁵⁵ and drunkenness⁵⁶ have all constituted such a disadvantage. Yet the process by which a disadvantage is recognised as a ‘special disadvantage’ is shrouded

⁴⁶ J. O’Donovan & J.C. Phillips, *The Modern Contract of Guarantee*, (London: Sweet & Maxwell, 2003) pp.56-64.

⁴⁷ *Crédit Lyonnais Bank Nederland NV v. Burch* [1997] 1 All ER 144.

⁴⁸ *Earl of Chesham v. Jensen* (1750) 2 Ves. Sen. 125 at 130.

⁴⁹ The reason for which is unclear although there is some evidence that in previous periods the doctrine had been abused: L.A. Sheridan, *Fraud in Equity*, (London: Pitman Publishing, 1957) 132-145.

⁵⁰ [1983] 1 All ER 944.

⁵¹ *ibid* at 961.

⁵² L.A. Sheridan & G.W. Keeton, *Fraud and Unconscionable Bargains*, (Chichester: Barry Rose, 1985) at 9-10.

⁵³ *Cresswell v. Potter* [1978] 1 WLR 255n.

⁵⁴ *Wood v. Abrey* (1818) 3 Madd. 417.

⁵⁵ *Hart v. O’Connor* [1985] 2 WLR 944.

⁵⁶ *Dunnage v. White* (1818) 1 Swan. 137.

in mystery.⁵⁷ Indeed, there is some evidence to suggest that the courts have taken a conscious decision not to elaborate on the concept of a ‘special disadvantage’.⁵⁸

Secondly, Peter Millett QC was clearly of the opinion that there needed to be a causal connection between the complainant’s special disadvantage and the resultant bargain, a view which is prevalent in the relevant case law.⁵⁹ However, there is another, albeit less common, approach evident in the case law, which one of the current authors has labelled as a ‘status approach’.⁶⁰ Under such an approach the courts appear, somewhat surprisingly, to have the power to relieve certain sections of society from improvident bargains regardless of whether there is a causal connection between their ‘special disadvantage’ and the resultant bargain.⁶¹

Thirdly, the view that the stronger party must act in a “morally culpable manner” is intriguing, not least because it sits uncomfortably with some of the seminal decisions on the doctrine. For example, in *Baker v. Monk*⁶² Turner LJ gave the following, valuable insight into the doctrine: “*I say nothing about improper conduct on the part of the Appellant; I do not wish to enter into the question of conduct... I am content to believe that in this case there has been no actual moral fraud on the part of the Appellant in the transaction.*”⁶³

Indeed it seems that Peter Millett QC imported this requirement from case law concerning collateral advantages in mortgage transactions,⁶⁴ a line of authority that has traditionally been considered *sui generis*.⁶⁵ Yet, whatever the origin of this phrase, its significance is dubious; it is not unarguable that such a requirement is

⁵⁷ J. Devenney & A. Chandler, *supra* n 10 at 543.

⁵⁸ *Niell v. Morely* (1804) 9 Ves. 478, *Montgomery v. Montgomery* (1879) 14 I.L.T.R 1 and *Cory v. Cory* (1747) 1 Vws. Sen. 19.

⁵⁹ J. Devenney, *An Analytical Deconstruction of the Unconscionable Bargain Doctrine in England and Wales* (Ph.D thesis, University of Wales, Cardiff, 2003) pp.1-7.

⁶⁰ J. Devenney & A. Chandler, *supra* n 10 at 549.

⁶¹ *Evans v. Llewellyn* (1787) 1 Cox CC 333 at 349; 29 ER 1191 at 1194, *Cresswell v. Potter* [1978] 1 WLR 255n.

⁶² (1864) 4 De G. J. & S. 388; 46 ER 968

⁶³ *ibid* at 425 (emphasis added).

⁶⁴ *Multiservice Bookbinding Ltd v. Marden* [1979] 1 Ch. 84.

⁶⁵ J. Devenney, ‘A Pack of Unruly Dogs: Unconscionable Bargains, Lawful Act (Economic) Duress and Clogs on the Equity of Redemption’ [2002] JBL 539.

satisfied merely by showing, for example, a causal connection between a complainant's special disadvantage and the resulting bargain.⁶⁶

Fourthly, it is clear that Peter Millett QC was of the view that substantive unconscionability was vital to the operation of the unconscionable bargain doctrine, although such a view is not beyond challenge.⁶⁷ Yet, even if we accept the view of Peter Millett QC on this point, the application of this requirement to suretyship transactions is not unproblematic. As we noted earlier, in a sense, a pure suretyship transaction is always manifestly disadvantageous - if we may borrow that phrase - to the surety as they are guaranteeing the debts of another. However, the courts have not adopted such a strict stance in analogous situations. For example, in *Portman Building Society v. Dusangh*⁶⁸ - a case where an old, illiterate man mortgaged his home to support the business ventures of his son - central to the Court of Appeal's refusal to utilise the unconscionable bargain doctrine was the view that the transaction was not to the manifest disadvantage of the father. In reaching this view, Simon Brown LJ stated:

“...it was not manifestly disadvantageous to this appellant that he should be able to raise money by way of re-mortgage so as to benefit his son...I would agree... But I simply cannot accept that building societies are required to police transactions of this nature to ensure that parents... are wise in seeking to assist their children...In short, the conscience of the court is not shocked.”⁶⁹

This was echoed by Ward LJ:

“So it was a case of father coming to the assistance of the son. True it is that it was a financially unwise venture... and the father's home was at risk. But there was nothing... which comes close to morally reprehensible conduct or impropriety. No unconscientious advantage has been taken of the father's...paternal generosity...The family wanted to raise money: the building society was prepared to lend it. One shakes one's head, but with

⁶⁶ J. Devenney & A. Chandler, above n 10 at 548.

⁶⁷ *Cooke v. Clayworth* (1811) Ves. 12; 34 ER 222.

⁶⁸ [2000] 2 All ER (Comm) 221.

⁶⁹ *ibid* at 228-230.

sadness and with the incredulity at the folly of it all, alas not with moral outrage.”⁷⁰

By contrast, in *Crédit Lyonnais Bank Nederland NV v. Burch*⁷¹ - a case where a young, junior employee acted as surety for her employer – the Court of Appeal were clearly of the opinion that the transaction could have been set aside under the unconscionable bargain doctrine if that doctrine had been pleaded.⁷² Millett LJ stated:

“This transaction cannot possibly stand... The transaction was not merely to the manifest disadvantage of the respondent; it was one which, in the traditional phrase, “shocks the conscience of the court”. The respondent committed herself to a personal liability far beyond her slender means, risking the loss of her home and personal bankruptcy, and obtained nothing in return beyond a relatively small and possibly temporary increase in the overdraft facility available to her employer...”⁷³

Even from these short passages, it is clear that the courts are engaged in difficult socio-culturally charged decisions related to the acceptability of particular suretyship transactions in particular contexts.

Finally, it must be remembered that suretyship transactions are tripartite transactions. Therefore, where it is alleged that the debtor’s unconscionable conduct has induced the transaction, recourse has to be made to the *O’Brien/Etridge* principles to determine whether or not the creditor is infected by such conduct.⁷⁴

Formative Regulation

A certain degree of protection is afforded by the formalities required in suretyship transactions.⁷⁵ In particular, the Statute of Frauds 1677, s.4, renders suretyship

⁷⁰ [2000] 2 All ER (Comm) 221 at 234.

⁷¹ [1997] 1 All ER 144.

⁷² *ibid* at 151 *per* Nourse LJ and 153 *per* Millett LJ.

⁷³ [1997] 1 All ER 144 at 152.

⁷⁴ *Crédit Lyonnais Bank Nederland NV v. Burch* [1997] 1 All ER 144.

⁷⁵ In *J. Pereira Fernandes SA v. Mehta* [2006] EWHC 813 (Ch) Judge Pelling QC: “[t]he purpose of the Statute of Frauds 1677 is to protect people from being held liable on informal communications

transactions unenforceable "...unless the agreement upon which such action shall be brought or some memorandum or note thereof shall be in writing and signed by the party to be charged therewith..." In addition, the Consumer Credit Act 1974, ss.105-106, specifies certain formalities and requires the provision of certain information in respect of securities provided in relation to regulated agreements.⁷⁶

Regulation of the Terms of the Suretyship Transaction

The traditional view is that the law of England and Wales is not concerned with substantive fairness in contracts.⁷⁷ However, a numbers of caveats need to be entered against this view in respect of suretyship transactions. First, substantive unfairness may sometimes be an essential component in establishing a vitiating factor.⁷⁸ For example, as is illustrated by *Dunbar Bank plc v. Nadeem*,⁷⁹ if undue influence is based on a notion of unconscionability, the relevance of the substantive fairness of the transaction will not merely be evidential.

Secondly, the principles of construction of suretyship transactions may also impact on the substantive fairness of the transaction. Traditionally, for example, the courts have taken a strict approach to construction when determining the extent of the surety's liability.⁸⁰ However, it should be noted that the principles of construction have been refined in recent years⁸¹ and this *might*⁸² impact on the traditional approach to construction in suretyship transactions.

Thirdly, suretyship transactions are, *in theory*, subject to the Unfair Contract Terms Act 1977 (UCTA) and the Unfair Terms in Consumer Contract Regulations 1999

because they may be made without sufficient consideration or expressed ambiguously or because such communication might be fraudulently alleged against the party to be charged" [16].

⁷⁶ See also Consumer Credit (Guarantees and Indemnities) Regulations 1983, as amended.

⁷⁷ *Hart v O'Connor* [1985] 2 All ER 880 at 887 *per* Lord Brightman.

⁷⁸ *cf.* Spanogle, *Analyzing Unconscionability Problems* (1969) 117 U. Pa. L. Rev. 931.

⁷⁹ [1998] 3 All ER 876.

⁸⁰ *Blest v Brown* (1862) 4 De G.F. & J. 367.

⁸¹ *Investors Compensation Scheme Ltd v. West Bromwich Building Society* [1998] 1 WLR 896 at 913.

⁸² *cf* *Liberty Mutual Insurance Co (UK) Ltd v. HSBC Bank plc* [2002] EWCA Civ 691 [56] Rix LJ: "the reasonable man does not expect fundamental principles of law, equity and justice, such as rights of set-off or of subrogation to be excluded unless the contract clearly says so."

(UTCCR). The Unfair Contract Terms Act 1977⁸³ may regulate attempts to exclude or limit a *creditor's liability* under a suretyship transaction.⁸⁴ Yet UCTA 1977 does not generally regulate clauses – commonly referred to as exclusion clauses – which seek to exclude or limit a surety's right to be discharged; such clauses aim to preserve the surety's liability rather than to exclude the creditor's liability.⁸⁵

Meanwhile, the Unfair Terms in Consumer Contract Regulations 1999 apply, with some exceptions,⁸⁶ “to unfair terms in contracts concluded between a *seller or a supplier* and a *consumer*”⁸⁷ and if applicable to suretyship transactions, it may be that a number of common exclusions would be vulnerable. Yet, the *sui generis* nature of surety agreements works to compromise application of the UTCCR to suretyships. Regulation 3 defines a seller/supplier as “any natural or legal person who...is acting for purposes relating to his trade, business or profession...” By contrast, a consumer is defined as “any natural person who is acting for a purpose which is outside his trade, business or profession.” The problem, of course, is that while the non-professional surety may supply a service, he or she is usually not acting in the course of a business; and the creditor, as beneficiary of the agreement, is clearly acting in the course of business.⁸⁸

Protection Afforded to the Surety during the Currency of the Suretyship Transaction

In addition to the protection inherent in the accessory and secondary nature of the surety's liability,⁸⁹ a surety will be afforded a measure of protection during the currency of the suretyship transaction through a mixture of contractual principles.⁹⁰ However, there is no general principle that the creditor must not act in a way that is

⁸³ Along with the Misrepresentation Act 1967, s.3.

⁸⁴ cf McCormack, above n 1, 166-167, *China & South Seas Bank Ltd. v Tan* [1990] 1 AC 536 and *Downsview Nominees v. First City Corp Ltd.* [1993] AC 295.

⁸⁵ McCormack, above n 1, at 167.

⁸⁶ Regulation 5(2).

⁸⁷ Regulation 5 (emphasis added).

⁸⁸ McCormack, above n 1 168-169. It is, however, possible to argue that the Regulations still apply to suretyship transactions: *Chitty on Contracts*, Vol. II (London: Sweet & Maxwell, 2004) para.44-133, although cf *The Governor and Co of the Bank of Scotland v Singh* (QBD, unreported, 17 June 2005).

⁸⁹ *Moschi v. Lep Air Services Ltd* [1973] AC 331, *Western Credit Ltd v. Alberry* [1964] 1 WLR 945 and *Walker v. British Guarantee Association* (1852) 18 QB 277.

⁹⁰ See disclosure obligations in the Consumer Credit Act 1974, ss. 103-113.

prejudicial to the surety.⁹¹ Moreover, the courts have been reluctant to impose a duty of care on the creditor to look after the economic interests of the surety.⁹²

III. CONTEXTUAL FACTORS

Suretyships may be either personal or proprietary, but to the extent that social welfare, property law and insolvency provisions exist to protect sureties in England and Wales, they are generally associated with proprietary security. In England and Wales, most sureties take the form of a security against real property, in many cases, the surety's home. However, these provisions are also relevant even in cases in which the debt is only personally guaranteed by a surety, as a creditor may be able either to bring bankruptcy proceedings as an unsecured creditor, or to seek *ex post facto* securitisation of the debt under the Charging Orders Act 1979, thus enabling the creditor to access the full range of remedies available to secured lenders under English law. Ultimately, whether the surety is personal or proprietary, a creditor may instigate proceedings for bankruptcy to ensure satisfaction of the debt, and the low level of protection afforded to sureties in the context of bankruptcy is evident in the explicit judicial policy whereby the court has determined to order the sale of the bankrupt's property, including property that is a family home, whether the creditor's security was obtained *ab initio* or following the issue of a charging order by the court, unless the circumstances are truly exceptional.⁹³

This section will outline the legal framework that regulates creditor actions against a surety's property, as well as setting out the scope of social welfare protections for surety's and other debtors in England and Wales.

Social Welfare

The provision of state-sponsored social welfare support to alleviate the impact of surety liabilities and other debtor default has declined considerably in recent decades, so that, to the extent that social welfare may have traditionally provided a 'safety-net'

⁹¹ *Bank of India v. Trans Continental Commodity Merchants Ltd* [1893] 2 Lloyd's Rep. 298.

⁹² *China and South Sea Bank Ltd v. Tan Soon Gin* [1990] 1 AC 536.

⁹³ *Re Citro* [1991] Ch 142, and discussion at n 20 to 42 and associated text.

against default on liabilities, it is now generally regarded as ‘unsafe’.⁹⁴ After the creation of the ‘welfare state’ in Britain general social welfare provision for either principal debtors or sureties who experienced difficulties in meeting their liabilities took two main forms: the indirect assistance afforded by tax relief against mortgage payments, and the safety-net provisions which entitled debtors to claim assistance with their housing costs when their income fell below a specified level. Provision for mortgage interest tax relief was established before World War II, but the significance of this tax exemption naturally grew with the expansion of homeownership, and what Lord Diplock characterised as the: ‘...emergence of a property-owning, particularly a real-property-mortgaged-to-a-building-society-owning democracy’,⁹⁵ in the second half of the twentieth century. However, just as the democratisation of credit and the rising proportion of home owners seeking to claim mortgage interest tax relief meant that mortgage interest tax relief was on the cusp of becoming a potentially widespread and significant welfare support for debtors, the government took steps to limit its availability. The decline in mortgage interest tax relief provision began in 1974, when relief was withdrawn for mortgage debts over £25,000; further reductions were made in 1991, until it was finally abolished in 2000.

The principal legislative framework for state ‘safety-net’ provision for debtors was introduced under the National Assistance Act 1948, and was aimed at ‘persons unable to manage for themselves’ financially.⁹⁶ The National Assistance Act 1948 marked the final shift from the ‘Poor Law’ approach to poverty and debt, which applied a policy of deterrence, to a social security perspective.⁹⁷ Within the framework of the modern British welfare state, the most potentially relevant area of social welfare provision for non-professional sureties is, in theory, social protection in the event of insecurity; however, the degree of protection afforded to sureties in the event of financial insecurity is extremely limited. This ‘safety-net’, which now includes both welfare benefits and tax credits, covers a range of circumstances including low income, childcare, unemployment, persons incapable of working due to illness or disability, pensioners and widows or widowers, and when sureties fall within one of

⁹⁴ L. Fox, *Conceptualising Home: Theories, Laws and Policies* (Oxford: Hart Publishing, 2006), at 220-228.

⁹⁵ *Pettitt v. Pettitt* [1970]AC 777 at 824, *per* Lord Diplock.

⁹⁶ R. Chambers, ‘The National Assistance Act 1948’ (1949) 12 *MLR* 69 at 70.

⁹⁷ *ibid.*

these categories, they may be entitled to social assistance benefits. However, the approach adopted towards more specific surety protection through social welfare protections in recent decades can be usefully illustrated by the changes in policy towards social assistance for mortgage payments.

In England and Wales, the form of security taken in a non-professional suretyship is usually a mortgage or re-mortgage of the surety's home and, in theory, the British welfare state has, since 1948, provided for welfare payments relating to housing for those who qualified for social assistance benefits. In the case of tenants, this took the form of a rent allowance ('housing benefit') while for owner occupiers, this could include assistance with mortgage payments (known as 'Income Support for Mortgage Interest'). However, the nature of this state-sponsored safety net provision in Britain has changed dramatically in the last decade. Following a substantial policy departure in 1995, which restricted Income Support for Mortgage Interest in various ways – including the circumstances in which assistance could be claimed, and the total loan amount covered - the responsibility for coping with debt, default, and economic 'distress' has been clearly shifted onto borrowers. The widespread privatisation of safety net provisioning in Britain means that debtors are now generally expected to protect themselves through private insurance policies, such as Mortgage Payment Protection Insurance (MPPI), Critical Illness Insurance, Permanent Health Insurance, and Unemployment Insurance, as well as drawing upon personal savings, reserves in a flexible mortgage and employee benefits. It is only when these avenues of relief are exhausted that the residual role of the state-sponsored social welfare system comes into play.⁹⁸

The decline in state-sponsored provision for defaulting principal debtors or sureties can be characterised as part of a: '...wider context of the restructuring of welfare and the ideological preference of successive governments (both Conservative and now Labour) to limit state welfare in favour of market provision and public/private partnerships.'⁹⁹ At the heart of this private market approach is the assumption that

⁹⁸ J. Ford, D. Quilgars, R. Burrows, D. Rhodes, *Homeowners Risk and Safety-Nets: Mortgage Payment Protection Insurance (MPPI) and Beyond* (London: Office of the Deputy Prime Minister, 2004), at 4.

⁹⁹ J. Ford, R. Burrows & S. Nettleton, *Home Ownership in a Risk Society: A social analysis of mortgage arrears and possessions* (Bristol: Policy Press, 2001), at 85.

borrowers will act rationally within the market place. It is noteworthy, however, that up-take has been lower than anticipated, and it was recently reported that: ‘...there remains a considerable disjuncture between the expectations of the government, lenders and insurers with respect to MPPI and the research evidence on the effectiveness of the policy.’¹⁰⁰

The extent of social welfare provision afforded to the owner-occupied sector is usefully contextualised in a report published by the Council of Mortgage Lenders, which compared state-sponsored support for the housing costs of poor households living in owner-occupied and in rented properties.¹⁰¹ This study indicated that while households living in poverty are spread equally across the owner-occupied and rental sectors, with half the poor owning and half renting, the degree of financial support each sector receives from the state varies dramatically. Taking 1998-99 as an example, it was noted that while low-income tenants received support (in the form of housing benefit) amounting to £11.2 billion in a year, support to low-income home-owners (in the form of ISMI and improvement grants) amounted to less than £1 billion. Thus: ‘...while low-income home-owners are half the poor, they get just 8% of the benefits.’¹⁰² This is significant against a backdrop in which the ‘democratisation of credit’ through the expansion of home ownership - thus giving potential sureties an asset against which to secure credit – has provided a significantly larger constituency of owner-occupiers who are potentially in a position to act as non-professional sureties, and so also potentially exposed to the risk of creditor action in the event of the debtor’s default. The erosion of state-sponsored safety-nets reflects a significant retrenchment in the social welfare system in England and Wales as it is likely to apply to non-professional sureties.

Creditor possession actions and bankruptcy provisions

The protections afforded to sureties under bankruptcy laws and other provisions relating to creditor actions against real property in England and Wales are also extremely limited. Firstly, it is worth noting that the legislative provisions and

¹⁰⁰ *ibid.* p.87.

¹⁰¹ R. Burrows & S. Wilcox, *Half the Poor: Home-owners with Low Incomes* (London: Council of Mortgage Lenders Research Report, 2000).

¹⁰² *ibid.*, Preface, viii.

judicial principles that determine the ability of a creditor to bring a successful action for the possession or sale of an occupied home are scattered across different areas of law, including provisions for the regulation of co-owned land, mortgage law and bankruptcy law. However, regardless of the legal context, one overwhelmingly consistent trend can be identified in English law: that regardless of the principles or provisions invoked by the creditor's action, once a debt is shown to be well-secured against the property, the claims of creditors are routinely elevated over those of debtors and sureties.

The main protection extended to sureties in this context is the essentially procedural requirement that - in the event that a creditor elects to exercise a remedy - the creditor must act for proper purposes and in good faith. As the Court of Appeal noted in *Yorkshire Bank plc v. Hall*:¹⁰³

“...a mortgagee's duty to the mortgagor or to a surety depends partly on the express terms on which the transaction was agreed and partly on duties (some general and some particular) which equity imposes for the protection of the mortgagor and the surety. The mortgagee's duty is not a duty imposed under the tort of negligence, nor are contractual duties to be implied. The general duty (owed both to subsequent incumbrancers and to the mortgagor) is for the mortgagee to use his powers only for proper purposes, and to act in good faith...The specific duties arise if the mortgagee exercises his express or statutory powers...If he exercises his power to take possession, he becomes liable to account on a strict basis (which is why mortgagees and debenture holders operate by appointing receivers whenever they can). If he exercises his power of sale, he must take reasonable care to obtain a proper price.”

This focus on the *conduct* of the sale reflects the reality that, in most cases, a creditor with a valid surety against real property will, in the event of default by the debtor, have such express or statutory powers as will enable it, without undue difficulty, to take possession and force the sale of the surety's property and so realise its capital value to discharge the debt.

¹⁰³ [1999] 1 All ER 879 at 893.

The legislative provisions and judicial principles that determine the ability of a creditor to bring a successful action against a surety to recover the principal's capital debt are scattered across various areas of English law, ranging from the regulation of co-owned land to mortgages, from bankruptcy law to family law. The form that these proceedings will take depends on several factors: whether the surety is a single individual or part of a 'family unit'; whether the action for sale of the surety's home arises in the context of bankruptcy proceedings; whether the debt is secured by way of a mortgage or some other form of proprietary security; whether the disputed property is solely or co-owned; and whether the property is occupied as a dwelling house, as a matrimonial home, or as a 'family home'. The form of the specific action brought by the creditor will be determined by these factors. Furthermore, the principles by which the outcome of a case will be decided vary from one form of action to another. In some contexts, the law has appeared to show greater sympathy for the protection of the surety's home – for example, in the context of bankruptcy, some additional provision is made for properties that are designated as 'family homes'.¹⁰⁴ However, although the English legislature and judiciary have, at various stages and in the context of different legislative frameworks and judicial principles, addressed specific aspects of creditors actions against those who are liable for the debt, including sureties, these disputes have generally been viewed within specific contexts and without, generally, giving any explicit consideration to the overall balance struck between the claims of creditors and the interests of occupiers.

Yet, despite the absence of a single coherent policy approach for creditor/occupier conflicts, particularly in relation to the basis of any protection afforded to sureties vis-à-vis creditors, one overwhelmingly consistent trend can be identified. Regardless of the specific context of the creditor's action, legislative and judicial policies have ensured that the interests of creditors are routinely elevated over those of sureties and other debtors. In fact, to some extent, any purportedly protective provision is likely to be of little practical value since a disappointed creditor will still hold the trump card of invoking bankruptcy proceedings against the surety in order to recover the debt.

¹⁰⁴ Insolvency Act 1986 ss336 and (as amended) 335A. See further below for discussion of the limited effectiveness of these purportedly protective provisions.

The decision in *Alliance and Leicester Building Society v. Slayford*,¹⁰⁵ highlighted the fact that even when the surety's interests might prevail over those of the creditor in one discrete context, for example where an occupier who has joint ownership of the property is able to successfully establish the priority of their interest over that of the creditor, a number of avenues remain open to the creditor. So long as the debt is well secured against the surety's interest in the property, a creditor may continue to proceed against the surety's 'share' of the property. Ultimately, a creditor may instigate proceedings for bankruptcy to ensure satisfaction of the debt and, as indicated below, in the context of bankruptcy the court has determined to order sale unless the circumstances are truly exceptional. Two matters are worthy of note: firstly, any evaluation of the balance struck between creditors' claims with those of non-debtor occupiers must adopt a holistic approach; and secondly, the outlook for the occupier is not good.

One consequence of the fact that little attention has been paid to achieving a more explicit and holistic policy approach to conflicts between creditors and sureties is that the overall consequences of the current *ad hoc* regime on each party's interests have, to a certain extent, been obscured. The complexity of the law in this area, and the way in which a surety may clear one hurdle, only to fall at the next, has distracted attention from the fact that the creditor has a range of alternative routes by which to achieve his goals. Ultimately, when the range of actions open to the creditor is viewed in the round, it is apparent that the surety's interests are marginalised by the weight attached to the interests of the creditor.

It is also interesting to note that in many of the cases considered below, the court exercises a discretionary power: whether to order the sale of a property at the request of a secured creditor; whether to delay possession proceedings so as to allow the debtor some time to make good on default; whether to grant a charging order for an unsecured creditor, thus opening up the possibility of further actions against the property; whether to allow the trustee in bankruptcy to realise the asset represented by the bankrupt's family home. When the court is called upon to exercise a discretionary power, that involves weighing the interests of the creditor against those of the

¹⁰⁵ [2001]All ER (Comm) 1.

occupier, it is, as Nourse LJ acknowledged in *Re Citro*: ‘...very hard to see how they can be weighed against each other, except in a way which involves some value judgment on the part of the tribunal.’¹⁰⁶ Across the range of creditor actions available under English law, it is clear that this value judgment is exercised in favour of the creditor.

The statutory powers available to a creditor who brings proceedings against a surety vary depending on whether the property against which the action is brought is owned solely by the surety, or jointly by the surety and a co-owner. Where property is owned by a single individual and the mortgagee is seeking to realize the capital represented by their security, they may either conduct an out-of-court sale, or seek a judicial order for sale of the property. One defining characteristic of solely owned (although not necessarily solely occupied) property is that, in relation to sale, the court may not even be called upon to weigh the interests of the creditor in selling against the interest of the surety in retaining the property, as the creditor may have an automatic out-of court right to sell the occupier’s home.

A mortgagee will have an automatic power to conduct an out-of court sale where the mortgage was made by deed, and the criteria set out in sections 101-103 of the Law of Property Act 1925 (LPA) have been satisfied. Section 101 provides that the power of sale arises once ‘the mortgage money has become due’, that is, after the legal date of redemption, as specified in the mortgage deed. The power of sale becomes exercisable whenever one of three conditions is satisfied:

- (i) notice requiring payment of the mortgage money has been served on the mortgagor or one of two or mortgagors, and default has been made in payment of the mortgage money, or of part thereof, for three months after such service; or
- (ii) some interest under the mortgage is in arrear and unpaid for two months after becoming due; or
- (iii) there has been a breach of some provision contained in the mortgage deed or in this Act, or in an enactment replaced by this Act, and on the part of the mortgagor, or of some person concurring in making the

¹⁰⁶ [1991]Ch 142 at 150.

mortgage, to be observed or performed, other than and besides a covenant for payment of the mortgage money or interest thereon.¹⁰⁷

The regulations are clear: so long as the requirements set out in sections 101-103 are satisfied, the mortgagee is entitled to sell the property, and does not need to seek the approval of the court. The mortgagee is automatically empowered, in these cases, to convey good title to the purchaser of the land, thus effectively converting their security interest in the debtor's home into capital.

Even when the conditions set out in sections 101-103 of the Law of Property Act 1925 are not satisfied, where the surety is the sole owner of a property, the creditor can still seek an order for sale from the court by making an application under section 91(2) of the Law of Property Act 1925, which provides: '...a [judicial] power to authorise sale "in any action" on "such terms as the court thinks fit."' ¹⁰⁸ In exercising its unfettered discretion, there is some support for the proposition that the court will look beyond financial matters, to take account of 'social considerations', although there has been no reported case to date in which such arguments have been successfully advanced to *prevent* the sale of property under section 91(2).¹⁰⁹ On the other hand, if the surety is a co-owner, an application for sale must be made under section 14 of the Trusts of Land and Appointment of Trustees Act 1996, which replaced section 30 of the Law of Property Act 1925. Although the court's discretion to order sale under section 30 was also unfettered, the policy of the court was to order sale at the creditor's request in the vast majority of cases.

Many of the applications brought under section 30 were made by trustees in bankruptcy, acting on behalf of the bankrupt's creditor(s). In bankruptcy cases, the court adopted a particularly stringent approach towards section 30 applications, developing a principle that the discretion to order sale should be exercised unless the

¹⁰⁷ Law of Property Act 1925, section 103.

¹⁰⁸ M. Dixon, 'Combating the mortgagee's right to possession: new hope for the mortgagor in chains?' (1998)18 *Legal Studies* 279, 292.

¹⁰⁹ See *Polonksi v. Lloyd's Bank Mortgages Ltd* (1997) 31 HLR 721; *Palk v Mortgage Services Funding plc* [1993] Ch 330, in which social considerations were taken into account when the occupying debtor wished to proceed with an earlier sale, against the creditor's preference to delay while waiting for the market to improve.

circumstances were exceptional.¹¹⁰ Even where the property was a family home, the court held that: ‘[b]ankruptcy has, in relation to the matrimonial home, its own claim to protection.’¹¹¹ The prospect that both the bankrupt and the bankrupt’s family would be rendered homeless and unable to acquire another mortgage were not sufficiently exceptional circumstances to justify refusing an order for sale to a trustee for bankruptcy,¹¹² or even for delaying the execution of the order.¹¹³ The prevailing approach was that: ‘...where there are debts outstanding, a sale should be ordered’;¹¹⁴ and that: ‘...one must be just before one is generous.’¹¹⁵

Even when section 336 of the Insolvency Act was enacted, with a view to providing greater protection for the *family home* in the context of bankruptcy proceedings, the commercial interests of creditors continued to prevail. Section 336(4) of the Insolvency Act 1986 required the court, when exercising its discretion to order the sale of a ‘family home’, to have regard to a range of factors, including:

“...the interests of the bankrupt’s creditors, the conduct of the spouse or former spouse...the needs and financial resources of the spouse or former spouse, the needs of any children, and all the circumstances of the case other than the needs of the bankrupt.”¹¹⁶

Yet, while this provision purported to provide the court with grounds on which to recognise the interests of the debtor’s family in retaining their home, it was tempered by section 336(5), which required the court, once a year had passed from the instigation of bankruptcy proceedings, to: ‘...assume, unless the circumstances of the

¹¹⁰ The court’s view that a trustee in bankruptcy’s application for sale should generally be acceded to was rooted in the trustee’s statutory duty to realise the debtor’s assets in favour of his creditors; *In re McCarthy, A Bankrupt*, [1975] 1 WLR 807 at 808.

¹¹¹ *Re Bailey* [1977] 1 WLR 278 at 279, *per* Megarry V-C. See also, *Re Solomon* [1967] Ch 573; *Re Turner* [1974] 1 WLR 1556; *Re McCarthy*, *ibid*; *Re Lowrie* [1981] 3 All ER 353; *Re Densham* [1975] 1 WLR 1519.

¹¹² *Re Lowrie*, *ibid*.

¹¹³ *In re Holliday* was the only reported case of a bankruptcy application under section 30 in which the court held that the sale of the home should be deferred for a short period of time, on the understanding that Mrs Holliday had some prospect of buying her bankrupt husband’s share of the property; [1981]Ch 405. The trustee’s application also received short shrift due to the court’s assessment of the action as a tactical move on behalf of the bankrupt, to avoid a property adjustment order in favour of his ex-wife.

¹¹⁴ *Re Lowrie* above, n21 at 355-6, *per* Walton J.

¹¹⁵ *ibid* at 284.

¹¹⁶ Insolvency Act 1986, section 336(4).

case are exceptional, that the interests of the bankrupt's creditors outweigh all other considerations.'

The courts also played an important role in copper-fastening the preference for high creditor protections after the enactment of the Insolvency Act 1986. Judicial policy with regard to applications for sale brought by trustees in bankruptcy under section 30 of the Law of Property Act 1925 was epitomised by the decision of the Court of Appeal in *Re Citro (a Bankrupt)*,¹¹⁷ when Nourse LJ concluded that, notwithstanding the factors set out in section 336(4), section 336(5): '...was intended to apply the same test as that which has been evolved in the previous bankruptcy decisions, and it is satisfactory to find that it has.'¹¹⁸ The Court of Appeal consolidated the approach adopted in the previous authorities, stating the general rule that trustees in bankruptcy ought to be granted an order for sale unless the circumstances were exceptional.

This strict approach has subsequently been extended beyond bankruptcy, to cases involving other secured creditors. Firstly, in *Lloyd's Bank Ltd v. Byrne*¹¹⁹ the Court of Appeal held that: '...there is no difference in principle between the case of a trustee in bankruptcy, and that of a chargee.'¹²⁰ and in *Barclay's Bank Plc v. Hendricks*¹²¹ this approach was also extended to cases where the creditor's security was obtained through a judicially imposed charging order. Thus, in any action brought by a creditor against the surety's land, whether bankruptcy proceedings have been instigated or not, and whether the liability was initially personal or proprietary, the courts developed a policy of ordering sale at the request of a creditor, unless the circumstances were exceptional.

With the enactment of the Trusts of Land and Appointment of Trustees Act 1996, the court's discretion to order sale under section 30 was superseded by a new discretion under section 14. Yet, although the section 14 discretion was accompanied by a list of factors to be considered by the court,¹²² which appeared to encourage greater

¹¹⁷ [1991] Ch 142.

¹¹⁸ *ibid* at 159, *per* Nourse LJ.

¹¹⁹ [1993] 1 FLR 369.

¹²⁰ *ibid.*, at 375.

¹²¹ [1996] 1 FLR 258.

¹²² The factors are set out in section 15 of the 1996 Act, and included regard for the intentions of the person who created the trust, the purpose for which the trust was formed, and the welfare of any

consideration of the context and consequences of ordering sale, these legislative changes have had only marginal impact on the outcome of creditor actions.¹²³ Indeed, following the 1996 Act, the courts have, with little exception,¹²⁴ continued to favour the creditor's interest in forcing sale.¹²⁵ For example, in *TSB Bank plc v. Marshall*,¹²⁶ Judge Wroath held that: '...the interest of the chargee will prevail except where there are exceptional circumstances.'¹²⁷ A similar approach has been adopted in the bankruptcy context: the Trusts of Land and Appointment of Trustees Act inserted section 335A into the Insolvency Act 1986, thus extending to the new regime the protection for family home that was ostensibly provided by section 336; however, section 335A also replicates the presumption that when an application for sale is brought more than one year after bankruptcy proceedings are instigated, the court *must* order sale unless the circumstances are exceptional. Furthermore, the court has only accepted circumstances as 'exceptional' in the most extreme of cases: to date, sale has only been delayed in cases where an occupier of the property is suffering from a serious illness, as in *Judd v. Brown*¹²⁸ when the court held that: '...a sudden and serious attack of cancer was an exceptional event...and was clearly distinguishable from problems such as organising substitute housing or rearranging children's schooling.'¹²⁹

minor occupant, as well as the interests of any secured creditor. Section 15(3) also directed the court to consider the interests of persons of full age entitled to interests in possession – that is, adult co-owners - with a consideration of the value of their interests.

¹²³ Even during the drafting of the Act, the Law Commission suggested that its provisions would: '...consolidate and rationalise the current approach' (Law Commission, *Transfer of Land: Trusts of Land*, (Law Com No. 181, 1989), para 12.9).

¹²⁴ cf *Edwards v. Lloyd's TSB Bank* [2004] EWHC 1745, concerning the welfare of minor occupiers.

¹²⁵ *TSB Bank plc v. Marshall* [1998] 39 EG 308; *Bank of Ireland Home Mortgages Ltd v. Bell* [2001] 2 All ER (Comm) 920; *First National Bank plc v. Achampong* [2003] EWCA Civ 487.

¹²⁶ *ibid.*

¹²⁷ *ibid.*

¹²⁸ [1998] 2 FLR 360.

¹²⁹ *ibid.*; see also *Claughton v. Charalamabous* [1999] 1 FLR 740, where the bankrupt's wife suffered from renal failure and chronic osteoarthritis, which imposed severe restrictions on her mobility; and *Re Raval (A Bankrupt)* [1998] 2 FLR 718, where the court allowed a postponement due to the wife's paranoid schizophrenia, notwithstanding that the condition was long term and of indeterminate duration. The court took account of the impact which 'adverse life events' such as moving to less suitable accommodation could have on Mrs Raval's health, and postponed the order for a year to enable suitable alternative accommodation to be found.

The emphasis on creditor protections, rather than protection for sureties or other debtors, was also evident in *Bank of Ireland Home Mortgages Ltd v. Bell*,¹³⁰ when Gibson LJ reasoned that:

“...a powerful consideration is and ought to be whether the creditor is receiving proper recompense for being kept out of his money, repayment of which is overdue...it is plain that by refusing sale the judge has condemned the bank to go on waiting for its money with no prospect of recovery...and with the debt increasing all the time, that debt already exceeding what could be realised on a sale. That seems to me to be very unfair on the bank.”¹³¹

At present, the landscape of English law clearly prioritises creditor claims over protections for sureties or other debtors. Yet, the determination with which the courts have adopted this pro-creditor stance may in itself present a possible avenue for future challenge. In *Barca v Mears*,¹³² the court considered the court’s policy of ordering sale in bankruptcy cases unless the circumstances were exceptional, in light of Article 8 of the European Convention on Human Rights, which includes the right to respect for home. Although the court concluded that, on the facts, the Deputy Registrar’s decision to order sale had been appropriate, the judge stated that the statutory provisions may be compatible with the Convention: ‘...without the possibly undue bias in favour of the creditors’ property interests embodied in the pre-1998 case law...’¹³³

IV. SYNTHESIS: THE SPHINX OF PROCEDURAL PROTECTION

In this paper we have sought to explore and uncover the standard of surety protection in England and Wales. We have demonstrated that the approach to surety agreements appears, at least at first blush, to be mainly pro-creditor and that such protection as exists is largely procedural in nature. Yet this procedural protection is enigmatic: it might be interpreted as providing little protection to the surety, setting hoops which

¹³⁰ [2001] 2 All ER (Comm) 920.

¹³¹ *ibid.* See also *Re A: A v. A* [2002] EWHC 611; *First National Bank plc v. Achampong* [2003] EWCA Civ 487.

¹³² [2004]EWHC 2170.

¹³³ *ibid* [42].

the creditor can easily jump through in order to hold the surety to his/her guarantee; on the other hand it might be argued that it encourages creditors to be pro-active by, for example, ensuring that independent advice is given. A further paradox of protection is that suretyships take their place in a broader spectrum of guarantees and a layering of protective mechanisms. This means that changes to the level of surety protection may be rapidly translated by the marketplace into new practice: enhancing surety protection may reduce resort to suretyships and increase resort to demand guarantees. Thus in seeking to ensure higher protective levels for sureties we may effectively reduce access to prime credit. Furthermore, when viewed comparatively, the level of surety protection achieved by different legal orders is heavily influenced by culturally specific attitudes to debt, levels of social welfare and the legal elaboration of insolvency procedures; thus each EC Member State looks to its own 'sphinx' in surety protection. The age-old linkage of remedies and rights in the common law – *ubi remedium, ibi ius* – is an aspect of this, conditioning an instinct to locate protection in *adjectival* law and to resort to substantive protection only when confronted with unambiguous market failure. A further paradox emerges from the fact that some mechanisms simply do not work as one might expect: the *Etridge* due diligence parameters were developed by the Courts rather than the credit institutions, despite the fact that creditors *should* have an economic self-interest in due diligence independent of any statutory regulatory framework. In this synthesis we briefly describe the parameters defining the bounds of surety protection.

In the first instance a surety receives some protection through the secondary and accessory nature of suretyship liability. In addition, in England and Wales suretyships are regulated through a medley of legal doctrines and principles. As we have seen, these doctrines and principles tend to have strong procedural and formative flavours. By contrast, less emphasis is put on the regulation of the terms of suretyship transactions. Moreover, the culture of private insurance rather than social welfare against economic distress and the strong pro-creditor bias that characterises judicial policy in disputes between creditors and those who have provided security for a transaction (whether primary debtor or not) has meant that the social welfare, property law and insolvency protections afforded to sureties in England and Wales are also relatively low.

The contrast to the more ‘continental’ approach is striking; rather than stringent statutory standards controlling ‘exemption’ clauses, a dedicated law on surety agreements, a focus on substantive justice or, even, the constitutionality of disproportionate guarantees, the approach in England and Wales pursues a case-law driven, pragmatic, procedural approach with emphasis on the parties’ freedom of contract and the importance of high creditor protections to ensure continued willingness to lend, thus safeguarding the availability of credit supplies. Fundamentally, as McCormack observes, this approach upholds individual autonomy rather than constitutionalising this area of private law.¹³⁴ This is echoed in Parry’s view that the English approach discloses a more pragmatic, less moralistic approach to debt and that this is connected to a matrix of considerations which vary considerably from one European state to the next - the extent to which credit has been ‘democratised’, the availability of consumer bankruptcy mechanisms and the extent of social welfare provision.

Central to the protection of sureties in England and Wales is the notion of undue influence, the application of which in this tripartite context is not without difficulty: typically the suretyship transaction is procured by the undue influence of the *debtor*, not the *creditor*. In such circumstances, the surety is usually only entitled to have that transaction set aside if the creditor either had actual or constructive notice of the debtor’s misconduct. As we have seen, constructive notice refers to situations where a creditor is *deemed* to have notice of the debtor’s misconduct by virtue of a failure to take certain steps, whether or not the creditor has actual knowledge of the debtor’s misconduct.

Therefore, the circumstances in which a creditor will be fixed with constructive notice of the debtor’s misconduct will be an essential factor in determining the extent of surety protection in England and Wales. In *O’Brien* and then *Etridge*, the House of Lords elaborated the steps incumbent upon the creditor to avoid being fixed with constructive notice. Essentially the creditor must “...take reasonable steps to satisfy

¹³⁴ McCormack above n 1 at 178. On constitutionalisation: A. Colombi Ciacchi, ‘Non-legislative Harmonisation of Private law under the European Constitution: the case of unfair suretyships’ (2005) *ERPL* 285, O. Gerstenberg, ‘Private law and the new European constitutional settlement’ (2004) 10 *ELJ* 766. O. Cherendnychenko, ‘The Constitutionalisation of Contract law: something new under the sun?’ (2004) 8 *EJCL* at www.ejcl.org.

itself that the...[non-commercial surety]...has had brought home to her, in a meaningful way, the practical implications of the proposed transaction.”¹³⁵ One way in which this may be achieved is by requiring the surety to obtain legal advice on the nature and risks involved in the transaction, and then for the solicitor to certify to the creditor that independent advice has been given.¹³⁶ In such cases, it is not essential that the solicitor acts for the surety alone.¹³⁷

In *Etridge* Lord Nicholls candidly acknowledged that the *O’Brien* principles were an imperfect compromise.¹³⁸ Nevertheless, the procedural rules established in *O’Brien* and *Etridge* can be criticised on a number of counts. First these cases can be criticised on the ground of possible conflicts of interest: the solicitor charged with advising the surety may find it difficult to avoid a conflict of interest where he/she serves two masters. Secondly, the *Etridge* approach can also be criticised for not focusing on the surety/creditor relationship but, instead, of focusing on the ‘constructive notice’ in the principal debtor/creditor relationship in order to free the surety of liability against the creditor largely because there is no other way of dealing with the situation.¹³⁹ Thirdly, it can be argued that the steps which a creditor needs to take to avoid being fixed with constructive notice, which are much clearer following *Etridge*, are not onerous. Although more time is required to assess the impact of *Etridge*, on such a view, the level of the protection afforded to sureties in England and Wales seems much reduced.

However the adjectival approach adopted under the law of England and Wales might be underestimated; it may indeed offer a lower threshold of protective intervention and more flexible remedies than many of the more constitutionally or substantive justice oriented continental systems of law.¹⁴⁰ As we have seen, a suretyship transaction may be *set aside* where (a) the debtor has exercised undue influence over the surety and (b) the creditor is fixed with constructive notice of the debtor’s

¹³⁵ [2001] UKHL 44 at [54].

¹³⁶ [2001] UKHL 44 at [55]-[56]

¹³⁷ [2001] UKHL 44 at [74].

¹³⁸ [2001] KL 44 at [37].

¹³⁹ M. Siems, No Risk no Fun? Should Spouses be Advised before Committing to Guarantees? A comparative Analysis (2002) ERPL 509 at 517. Principles of unconscionability may, however, inform the *O’Brien* principles: cf McCormack, n 1 at 175-177.

¹⁴⁰ Parry, *supra* n 3 at 362.

misconduct; importantly the former can be presumed and the latter can spring from the mere fact that the relationship between the debtor and the surety is non-commercial in nature. Yet this is only part of the story; following *Etridge* creditors are now, to an extent, incentivised to be pro-active in all cases of non-commercial sureties. By way of contrast, the German approach institutes a high threshold for intervention, which focuses on life-long indebtedness rather than the surety's home ownership.¹⁴¹ What the German courts look for, rather than undue influence, is an *excessive* or *gross* disproportion between the guarantee and the surety's income and assets.¹⁴² This may begin to explain why suretyship transactions are far less ubiquitous in England than in Germany: reducing the effective protection provided by the substantive justice approach means that creditors find suretyships more attractive in Germany than in England. By extension, less resort is thus made of other types of guarantee; with the result that access to credit is, arguably, more broadly and diversely ensured on better conditions.¹⁴³

V. CONCLUSIONS

Consideration of the remedies afforded to creditors by property law and under insolvency provisions has indicated that, once the creditor has cleared the hurdle of establishing a valid contract for surety, the English courts are almost always rigorous in ensuring that the creditor can then pursue the debt, to the point of instigating bankruptcy and forcing the sale of the surety's assets, including their (family) home. Accordingly, general contractual vitiating factors – and in particular undue influence – are the main source of surety protection in England and Wales. Yet it can be argued, notwithstanding *Etridge* and the procedural safeguards established therein, that no

¹⁴¹ Parry, *supra* n 3 368 'A contract of suretyship which resulted in a loss of the family home would be tolerated under German law, since this loss would not be sufficient in itself to indicate that the debt glaringly overburdens the surety.'

¹⁴² P. Rott, 'Risikohaftung der Banken fuer 'Schrottimobilien'' (2006) GPR 25; P. Rott, Linked Contracts and Doorstep selling (2006) 1 Yearbook of Consumer law 403; P. Rott, German law on Family Suretyships: an overrated System, in Colombi-Ciacchi (ed.) n 1 at 51-69 (Referring to Constitutional court decision: BVerfG NJW 1994, 36), at 54: Court holding '...party autonomy... is absent where one party abuses the structural weakness of the other party. In such cases, the weaker party must be protected ... The civil courts have to afford... protection through the general clauses of immorality, §138 BGB (German Civil Code), and of good faith, §242 BGB.' At 55: 'Under the newly established court practice, the primary criterion is the disproportionality between the amount guaranteed and the income and property of the guarantor. If the amount guaranteed is grossly disproportionate... and there is a close relationship between... debtor and... guarantor the courts recognise a rebuttable presumption of immorality in terms of § 138(1) BGB.'

¹⁴³ Kenny, *supra* n 5 at 195-196.

matter how much information is supplied, it will always be insufficient. Sureties will still enter into agreements out of love, dependency or vulnerability. The acid question is whether it is more efficient in such cases to trust more in procedural requirements directed at the creditor, or to rely on approaches which focus more directly on defects in sureties consent and/or the substantive unfairness of the contract.¹⁴⁴ It may also be disputed whether the procedural standards laid down in *Etridge* are stringent enough to protect the vulnerable surety, and that, instead, the steps identified simply map out the procedural hoops that the creditor has to master to be able to rely on the agreement. Clearly further case law is required if these points are to be answered. Nevertheless, this is not a zero-sum game, and every choice entails costs and benefits. The problem with a lower trigger to intervention and an *effectively* higher standard of protection - as the proceduralised standard in *Etridge* may be suggested as leading to when compared, for example, with the constitutionalised (higher trigger, *practically* lower) standard of protection in Germany - is the potentially damaging effect this has on the resort to surety arrangements amongst the spectrum of guarantee instruments.¹⁴⁵ Indeed a reduction in the prevalence of surety agreements may simply deflect problems related to social justice and access to credit to other areas of contract law.

¹⁴⁴ Parry, *supra* n 3 at 363.

¹⁴⁵ Kenny, *supra* n 5 at 195 and Rott *supra* n 142.