England and Wales High Court (Queen's Bench Division) Decisions

Neutral Citation Number: [2006] EWHC 533 (QB)
Case No: HQ03X02698

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION

Royal Courts of Justice
Strand, London, WC2A 2LL
17th March 2006

B e f o r e :

MR JUSTICE STANLEY BURNTON

Between:

Barclays Bank PLC	**Claimant**
- and -	
Alan Roger Kingston **Christopher Miles Kelly** **Malcolm St.Clair Grant** **Noel Verbruggen** **Tom Dixon**	**Defendants**

Adam Zellick (instructed by Matthew Arnold & Baldwin) for the Claimant
Thomas Roe (instructed by Manches LLP) for the Defendants
Hearing dates: 17 January 2006

HTML VERSION OF JUDGMENT

Mr Justice Stanley Burnton:

Introduction

1. In these proceedings, the Claimant ("the Bank") seeks to enforce the alleged liability of the Defendants under a guarantee ("the Guarantee") dated 11 December 2000 by which the Defendants each personally guaranteed the liabilities to the Bank of Kingstonian Football Club Limited ("KFC"), of which they were directors. The Guarantee was limited to £100,000 plus interest and costs.

2. This is the trial of a preliminary issue agreed by the parties and ordered by Master Tennant on 6 July 2005, namely:

> "Whether notwithstanding the Defendants' Re-Re-Amended Defence alleging sale of the Kingsmeadow Stadium at an undervalue, the express terms, in particular clauses 1, 3, 5 and 6, of the guarantee entered into by the Defendants are effective to make the Defendants liable under that guarantee."

Background

3. KFC borrowed a total of £627,500 from the Bank. In addition to the Guarantee, KFC's borrowings were secured by a legal charge over KFC's football ground, Kingsmeadow Stadium ("the Property").

4. By October 2001, KFC was in very serious financial difficulties. The Defendants, as directors, applied to the High Court for an Administration Order. By an order dated 24 October 2001, joint administrators were appointed of KFC. Thereafter KFC was in the hands of its Administrators.

5. On 24 October 2001, the Claimant served demand under the Guarantee on all the Defendants.

6. On 22 April 2002, the Administrators sold the Property with other fixed and floating charge assets for £445,000. Of this recovery, the Claimant received £300,000. A new company called "Kingstonian FC Limited" continued the football club.

7. KFC was eventually wound up on 29 July 2003. The distribution to creditors was 0.013 pence in the pound. After the liquidation, KFC's unsatisfied indebtedness to the Claimant was £136,000 and so the Claimant invoked the Guarantee to its limit of £100,000.

8. The Defendants' Re-Re-Amended Defence raises only one defence, which is that the Property was sold at an undervalue. The defence is based on an equitable duty of care to obtain a proper price for the Property. The Defendants' case is that the Bank "caused or permitted" the sale by the Administrators at an undervalue; that in consequence there was a breach of the equitable duty of care, with the effect that the value of the Guarantee was reduced by the same amount as the value wrongly lost from the Property. The Defendants believe that the value lost in the sale of the Property was greater than the £100,000 value of the Guarantee such that no value remains in the Guarantee at all.

9. The preliminary issue is whether, even if the Defendants' above defence might otherwise succeed, the express terms of the Guarantee are nevertheless effective to make the Defendants liable to the Bank for the entire amount outstanding.

10. As mentioned above, the Property was sold by the Administrators as an asset of KFC, rather than by the Bank under the powers conferred by its charge. Both parties have argued their respective cases on the basis that if the Bank interfered with the sale by the Administrators,

the respective rights and liabilities of the Bank and the Defendants were the same as they would have been if the Property had been sold by the Bank's agents under a power of sale.

11. There is a point to be made about the preliminary issue. Care is always required in deciding whether a preliminary issue will result in a saving of costs and in its drafting. In theory, there are three possible results in a case such as the present. The first is that the guarantors are liable to the creditor irrespective of any defect in the sale of a security, and the creditor has no liability to them for any undersale: i.e., a sale at an undervalue does not affect their liability or rights. The second is that their liability is reduced by the amount of the undersale: i.e., they are entitled to credit not merely for the sum realised by the creditor, but for the sum that the creditor should have realised by the sale of the security. The third is that the guarantors are required to pay on demand the sum demanded by the creditor (i.e. the liabilities of the debtor less the sum actually realised on the sale of the security), but the debtor and the guarantors may pursue their claim against the creditor for the difference between the sum actually realised and the sum that should have been realised. That was the effect of the guarantee considered by the Court of Appeal in *The Fedora* [1986] 1 Lloyd's Rep 441. In such a case, the provisions of the guarantee go to timing and cash flow rather than liability. The preliminary issue as drafted does not address this possible result. If, on its true construction the Guarantee in this case has a similar effect to that in *The Fedora*, the Defendants would be required to pay the Bank's claim, but, provided they remain solvent, they would be free to pursue their claims against the Bank to trial. In that event, the preliminary issue would not have resulted in any saving of costs.

The contentions of the parties

12. For the purposes of the preliminary issue, it is to be assumed that the Bank was responsible for the sale of the Property at an undervalue, and that if due care had been taken in its sale the liability of KFC as the principal debtor, and in consequence that of the Guarantors, would have been extinguished. The administrators were not the agents of the Bank, and it seems to me that it is to be assumed that the Bank caused the sale at an undervalue, if such there was, rather than it merely permitted a sale at such a value.

13. For the Bank, Mr Zellick's principal submission was that the express terms of the Guarantee, viewed individually and in the context of the instrument as a whole, made it clear that the guarantors are liable to the Bank notwithstanding any careless realisation of a security given by the principal debtor. He also suggested that the Bank owed no duty to the guarantors, who had paid nothing in satisfaction of their liabilities to the Bank. For that purpose, he relied on the judgment of Lightman J in *Burgess v Auger* [1998] 2 BCLC 478.

14. Mr Roe submitted that the Bank owed a duty to the Defendants to take reasonable steps to obtain a proper price for the Property; that the terms of the guarantee relied on by the Bank should be narrowly construed, as purporting to exclude its common law liabilities; and that the terms relied upon were insufficient to exclude its duty to the Defendants.

Discussion: (a) General principles

15. The duties of mortgagees to mortgagors are largely the product of equity rather than the common law. In relation to a security such as a mortgage of a property, the duties of the creditor and the rights of the guarantor will vary with the circumstances of the case. If the taking of the security unless and until it is realised by the creditor is a term of the contract between the creditor and the principal debtor whose performance the guarantor has guaranteed, the guarantor will be wholly discharged if the creditor releases the security without the consent of the guarantor. Any variation of the principal contract without the consent of the guarantor will discharge him, unless the variation is obviously insignificant

or is clearly only capable of being beneficial to the guarantor: *Holme v Brunskill* (1878) 3 QBD 495. In that famous case, Cotton LJ, with whose judgment Thesiger LJ agreed, said, at 505-6:

> The true rule in my opinion is, that if there is any agreement between the principals with reference to the contract guaranteed, the surety ought to be consulted, and that if he has not consented to the alteration, although in cases where it is without inquiry evident that the alteration is unsubstantial, or that it cannot be otherwise than beneficial to the surety, the surety may not be discharged; yet, that if it is not self-evident that the alteration is unsubstantial, or one which cannot be prejudicial to the surety, the Court, will not, in an action against the surety, go into an inquiry as to the effect of the alteration, or allow the question, whether the surety is discharged or not, to be determined by the finding of a jury as to the materiality of the alteration or on the question whether it is to the prejudice of the surety, but will hold that in such a case the surety himself must be the sole judge whether or not he will consent to remain liable notwithstanding the alteration, and that if he has not so consented he will be discharged.

16. The creditor is normally under no duty to the principal debtor or to any sureties to realise any securities. He cannot be compelled to realise a security at any particular time or at all. But if he does realise a security he must do so prudently, with reasonable care, so as to seek to obtain a proper price. The duty to take reasonable care to obtain a proper price is owed to the principal debtor (assuming it is he whose asset constitutes the security), since his liability to the creditor should have been reduced by the full value of the security: *Cuckmere Brick Co v Mutual Finance* [1971] Ch 949.

17. A guarantor of the principal debtor's liabilities is also interested in the security, in two respects. First, before realisation by the creditor, if he pays the amount owed by the principal debtor he will be entitled to the security by way of subrogation to the rights of the creditor. Secondly, his liability, like that of the principal debtor, falls to be extinguished or reduced by the amount realised by the creditor when he realises the security, assuming it to be sufficient. If the guarantee is of only part of the indebtedness of the principal debtor, whether the guarantee's liability falls to be reduced, and if so by how much, will depend on the amount realised and the amount of the total indebtedness, but that is a complication that does not affect this discussion, since in the present case it is alleged that a sale of the Property at a proper price would have discharged the entirety of the indebtedness of KFC.

18. It is because of the second of these interests of the guarantor that the creditor owes him, as well as the principal debtor, a duty, if he realises a security for the liabilities of the principal debtor, to do so at a proper price. It is this duty that the Defendants allege was broken by the Bank in this case. Of course, the creditor is not liable to both the principal debtor and the guarantor cumulatively. The liability of the principal debtor to the creditor will be reduced by the amount of the undersale, and if the guarantor has guaranteed the entirety of that liability his liability to the creditor will be similarly reduced.

19. That the duty of the creditor is owed to a surety as well as to the principal debtor is established by a number of authorities. See *Standard Chartered Bank v Walker* [1982] 1 WLR 1410 (although this was an appeal by defendants against summary judgment against them, so that strictly the issue was whether there was an arguable defence); *American Express v Hurley* [1985] 3 All ER 564; and, more recently, by the Court of Appeal in *Skipton Building Society v Stott* [2000] 1 QB 261 at [21]. I do not think that the decision in *Skipton Building Society v Stott* in relation to the guarantor can be explained on the basis of

the statutory duty of a building society under the then applicable Building Societies Act 1986, since the Court of Appeal decided it on the basis of the authorities at common law and in equity. That decision is binding on me. It follows that *Barclays Bank v Thienel* (1978) 247 EG 385, a decision of Thesiger J, must be regarded as wrongly decided.

20. In *Burgess v Auger* [1998] BCLC 478 Lightman J held that a creditor and a receiver had no duty to a guarantor. The decision, which was on the pleadings, may be explained on the basis that he had paid nothing on the guarantee and his liability to the creditor was statute-barred: see at 483. It follows that the guarantor had ceased to have any interest in the security. To the extent that the judgment of Lightman J has been taken as authority for the proposition that a creditor owes no duty to a guarantor if he realises a security unless the guarantor has satisfied the creditor's claim against him, it cannot stand with *Skipton Building Society v Stott*. In my judgment, the duty to the guarantor arises not because he may in certain circumstances become interested in the equity of redemption of the mortgaged property (as suggested in *Burgess v Auger*), but because of his interests in the security to which I have referred in paragraph 17 above.

21. Mr Zellick also referred me to the decision of the High Court of Australia in *Buckeridge v Mercantile Credits Ltd* (1981) 147 CLR 654, the headnote to which includes the statement that the appellant guarantors "were not entitled to any rights under securities held by the financier because they had not paid any amount under the guarantee". However, the principal claim of the guarantors in that case was that the creditor should have exercised a power of sale under his mortgage, instead of appointing a receiver and manager of the mortgaged property. A creditor is entitled to choose which of his powers over his securities he exercises. He cannot be compelled by a guarantor who has no subrogated rights to exercise a power of sale; it is only if he decides to exercise it negligently that he may incur liability to the creditor and guarantor. The guarantors in that case therefore had no basis for complaining that the creditor should have exercised one power (to sell as mortgagee) rather than another (to appoint a receiver and manager under a debenture). In any event, the guarantors failed to establish that the manner of sale was to their disadvantage. The High Court did not suggest that a creditor who sells at an undervalue would not be liable to a guarantor. Brennan J said, at 675:

> In a case where the act of a creditor does not discharge a surety, but the creditor has nonetheless sacrificed or impaired a security, or by his neglect or default allowed it to be lost or diminished, the surety is entitled in equity to be credited with the deficiency in reduction of his liability.

22. I am fortified in these conclusions by the statements to similar effect in Andrews & Millett, *Law of Guarantees* (4th edition, 2005) at paragraphs 9-043 and 11-018, and in O'Donovan & Phillips, *The Modern Contract of Guarantee* (2003), at paragraph 8-85.

23. Normally, it is the debtor who may be expected to pursue any claim against the creditor that the latter has undersold a security. If the debtor succeeds in his claim, his indebtedness to the creditor will be reduced, as will the liability of the surety. However, the fact that the creditor owes a distinct duty to sureties may be relevant if the debtor has ceased to exist or for any other reason does not pursue his own remedies against the creditor. In the present case, I am told that KFC has been wound up. It is therefore only the sureties who may be able to pursue the claim that the creditor caused the Property to be undersold.

24. However, just as the obligations and rights of a surety are, in a case such as the present, created by a contract, so may they be modified by the terms of the contract between himself and the creditor. It is to those that I now turn.

The terms of the Guarantee

25. The Guarantee was in the Bank's standard printed form. It defined "Customer" as KFC, and "Customer Liabilities" as

> "any money and liabilities which the Customer now owes us or may owe us in the future in any way. This includes liabilities which:
>
> depend upon events which may or may not happen,
>
> the Customer incurs or has incurred with any other person or persons,
>
> the Customer incurs or has incurred as surety for the liabilities of someone else.
>
> It also includes all interest, fees and other charges which the Customer owes us now or in the future (whether or not they are charged to the Customer's account)."

26. The relevant provisions of the Guarantee were as follows:

> "1.1 We have agreed, or may agree in the future, to provide or continue to provide banking facilities to the Customer. In return, you unconditionally guarantee that all Customer Liabilities will be paid or satisfied. You will immediately have to pay the amount guaranteed when we demand payment. We do not need to demand payment from the Customer first. We may make one or more demands for payment.
>
> 2.1 This Guarantee is a guarantee of the full amount of all Customer Liabilities. However, the total amount you have to pay under this Guarantee will not be more than:
>
> a the Specified Amount; plus
>
> b interest on the Specified Amount (or, if less, the amount of the Customer Liabilities) after we demand payment from you, or after the end of any notice you give under condition 4, until you have paid in full; plus
>
> c ...
>
> ...
>
> 3.1 You will continue to be bound by this Guarantee regardless of any changes in the amount or nature of the Customer Liabilities, your death or mental illness, or any other matter. However, you can stop this Guarantee under condition 4.
>
> 3.2 Until the Customer Liabilities are paid in full, any payment you make under this Guarantee will not entitle you to:
>
> a share in any security we hold or any money we receive;

b enforce any right or pursue any claim against the Customer or any surety; or

c make any claim in the insolvency of the Customer or a Surety which would compete with our claim.

In the meantime we may hold any money we receive under this Guarantee on 'suspense account' to protect the full amount of our claims against the Customer or under any other guarantee or security for the Customer Liabilities. However, when we work out the interest on the Customer Liabilities which you have to pay, we will treat them as reduced by the amount we hold on suspense account.

5.1 This Guarantee is independent of any other security or guarantee which we hold or may hold in the future for the Customer Liabilities.

When we hold any other security or guarantee, we may choose which security or guarantee we will enforce and, if we enforce more than one, the order in which we do so. However, we will not have to enforce any other security or guarantee, or take any steps or proceedings against the Customer, before we enforce this Guarantee.

5.3 From time to time we may:

a provide the Customer with any credit or facilities

b vary, cancel or refuse any credit or facilities;

c give the Customer time to pay any money owing to us;

d make another arrangement, compromise or settlement with the Customer or any other person;

e take or deal with any security, guarantee or other legal commitment for the Customer Liabilities; or

f release, enforce or not enforce our rights under any such security, guarantee or commitment.

If we carry out any of the above acts, or do or fail to do anything else, this will not affect our rights under the Guarantee, even if it would have done so if this condition did not exist.

6. You will be liable to us as a principal debtor for any Customer Liabilities that cannot be recovered from you as a guarantor, whatever the reason and whether or not we know the reason. This is a separate commitment, extra to the guarantee in condition 1.1. You must pay the amounts you are liable for under

this separate commitment as soon as we demand payment. The total amount that you will have to pay will be no more than that mentioned in condition 2."

27. The "Specified Amount" was £100,000.

Discussion: (b) the effect of the terms of the Guarantee

28. Mr Zellick submitted that the provisions of the Guarantee on which the Bank relies should not be construed with the hostility conventionally due to exemption clauses. In support of this proposition, he referred to the judgment of the Court of Appeal in *The Fedora*. However, in that case the Court of Appeal declined to construe the provision relied upon by the creditor as if it were an exclusion clause because it did not affect the liability of the creditor, which the guarantor was free to pursue once he had paid the sum demanded by the creditor: see the judgment of Parker LJ at [1986] 1 Lloyd's Rep 444. In *American Express v Hurley*, Mann J interpreted the provision of the guarantee relied upon by the creditor as an exemption clause: see at [1985] 3 All ER 571.

29. I do not approach the provisions of the Guarantee with the hostility traditionally shown to exemption clauses. I shall seek to interpret the Guarantee as a whole as a commercial document and to give it a sensible meaning. However, I do so against the background that it is a standard document prepared by the Bank; that the fact that the Bank has taken as security a charge over a valuable property is likely to encourage a person to give a guarantee; and that a guarantor is entitled to enter into a guarantee in the expectation that if the creditor chooses to realise another security, he will do so properly so as to realise the market value of the property charged, which will go to reduce the liability of the guarantor, unless the terms of the guarantee clearly indicate otherwise. I do not ignore the fact that the guarantor is entitled to be indemnified by the debtor; but since the guarantee is unlikely to be called upon if the debtor is able to meet his liabilities, the right to indemnity from the debtor is likely to be of little value.

30. I do not think that clause 1.1 assists the Bank. If it had claimed against the Defendants without realising the Property, they would clearly have been liable immediately to pay the Specified Amount to the Bank. However, if it sold the Property at an undervalue, KFC was entitled to an account of what should have been received by the Bank and to have that sum applied in reduction of its liabilities: see *Silven Properties Ltd v Royal Bank of Scotland Plc* [2004] 1 WLR 997 at [19]. In my judgment, on a sale of a security, the "money and liabilities which the Customer now owes (the Bank)" within the meaning of the definition of Customer Liabilities are that money and those liabilities reduced by the sum received by the Bank on that sale, or which it should have received. If the Bank did cause a sale of the Property at an undervalue, and a sale at a proper price would have reduced the liability of KFC to the Bank to an amount less than £100,000, or extinguished it, the liability of the Defendants to the Bank has similarly been reduced or extinguished. I contrast the wording of clause 1 with the explicit provision "without set off-or counterclaim and without deductions or withholdings whatsoever" considered by the Court of Appeal in *The Fedora*. Clearer words than those in clause 1 are required to impose on a surety a liability exceeding that of the debtor. I add that in any event the requirement of immediate payment would not exclude the liability of the Bank, but would entitle it to be paid the sum claimed, leaving the Defendants to pursue their counterclaim to trial: i.e., the position would be the same as in *The Fedora*.

31. For the same reason, the provision in clause 2.1 that the Defendants pay all Customer Liabilities does not take the claim any further. Nor does clause 3.1, which permits the Bank to vary the amount it lends to the Customer without reference to the Guarantor, but does not

address the present issue. Clause 3.2 too is irrelevant. Its object is to make it clear that the Guarantor has no right of subrogation to any security until all the Customer Liabilities (and not merely the Specified Amount) have been paid to the Bank.

32. The provision in clause 5.1 that the Guarantee is independent of any other security again does not affect the present issue. It may enable the Bank to deal separately with other securities and other guarantors. It does not affect the right of subrogation if the Guarantor makes payment of the entirety of the Customer Liabilities (in a case in which they are less than £100,000); nor, in my judgment, does it affect the liability of the Bank to take proper steps to realise a security if it chooses to do so.

33. The realisation of a security is clearly not within any of the paragraphs a to d of clause 5.3. I do not think it is within paragraph e, but if it is, that paragraph does not extend to a failure to take reasonable steps to obtain a proper price. Similarly, the enforcing of rights under any security referred to in paragraph f does not, in my judgment, include an improper or defective enforcement of rights giving rise to claims on the part of the debtor and the Guarantor.

34. It follows that the words in the last sentence of clause 5.3 "If we carry out any of the above acts" do not assist the Bank. The Defendants complain not that the Bank caused the Property to be sold, but that it caused it to be sold at an undervalue. Their complaint is not as to the sale as such, but as to its manner and consequent result.

35. The words in clause 5.3 "or if we do or fail to do anything else" have given me more pause for thought; but in the end, I do not think they assist the Bank. The Defendants complain not that the Bank did or failed to do anything "else", i.e. something other than (in the present case) enforcing its rights under its security over the Property as mentioned in paragraph f, but that the Bank defectively enforced those rights. And so I do not think that as a matter of drafting those words assist the Bank. In addition, I think that clearer words would be required to exclude the liability of the Bank for a defective sale at an undervalue. The meaning of the words "or if we do or fail to do anything else" is influenced by the preceding paragraphs of clause 5.3. None of those indicates that the clause is concerned with a breach of duty by the Bank, i.e. its negligently failing to realise a proper price for a security or causing a security to be realised at an undervalue.

36. Lastly, clause 6 too does not assist the Bank. Its effect is to render a guarantor liable as an indemnifier if his liability as guarantor is discharged or reduced. However, an indemnifier is in my judgment similarly entitled to have his liability reduced by the amount that a creditor should have realised on the sale of a security. I see no reason why a creditor when realising a security should not owe the same equitable duty to a party who has given an indemnity against a debtor's liabilities as he does to a guarantor.

Conclusion

37. For the above reasons, I do not think that the provisions of the Guarantee render the Defendants liable if the Bank has been responsible for a sale of the Property at an undervalue. The preliminary issue will be answered, "No."
