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We're caught in a trap, I can't walk out" – the latest on continuing guarantees

By Markus Esly

In *Euler Hermes SA* v *Mackays Stores Group Ltd* [2022] EWHC 1918 (Comm), the Commercial Court has considered whether a guarantor still had to pay against a demand made two months after the guarantee had been terminated. The decision helps to illustrate when guarantors remain on the hook for continuing or contingent liabilities that have arisen after the term of their guarantee has come to an end. The decision also addresses the enforceability of clauses which state that the beneficiary of a guarantee can self-certify the amount that the guarantor has to pay – so-called 'conclusive evidence' provisions.

The facts

The case concerned the Mackays group, a retail company which operates a chain of retail stores now trading under the "M&Co" name. In December 2013, Mackays entered into bond and guarantee facility agreement with Euler Hermes SA ("Euler"), a provider of trade credit, insurance and other financial services. This facility agreement was for the benefit of certain subsidiaries in the Mackays group, whose liabilities Euler would guarantee by entering into separate surety agreements with the subsidiaries' counterparties. The facility agreement said that Euler would guarantee "*… the contractual obligation of* [the Mackays subsidiaries] *as required by parties contracting with …*" them. The parties agreed that the facility agreement would remain in force until it was either (i) terminated in writing by Euler or (ii) "… *as and when Euler has been released from all liabilities and obligations under any Bonds issued under the Facility.*"

In return, the facility agreement required that a top level Mackays company enter into an indemnity agreement with Euler, by which Mackays agreed to indemnify Euler against any "*Ultimate Liability*", which was widely defined as:

> "*Any liability (actual, prospective or contingent) and also any claim and every other loss expense damage or cost of whatsoever nature and howsoever arising which at any time may be incurred by* [Euler] *in any way in connection with the Facility.*"

The indemnity also stated that Euler had full discretion to pay out sums to third parties under any guarantees or bonds issued by it pursuant to the facility, and that once Euler had made such a payment, Mackays had to indemnify and pay Euler that same amount on demand. Such a demand was agreed to "… *constitute conclusive evidence of the fact and the aggregate amount of the liability ...*".

Ultimately, the only bond or guarantee provided by Euler under the facility was in favour of HMRC. On 1 January 2014, Euler entered into a contract on HMRC's standard terms pursuant to which Euler guaranteed the payment of tax due to HRMC by a Mackays company, and in light of that guarantee HMRC would then be prepared to defer payment of that tax to a later, specified date – thus helping Mackays with their cash flow. Euler undertook to pay HMRC *"… immediately and on demand* …" any such deferred tax. The key provision in Euler's HMRC guarantee was the termination clause, which read:

> "*If not less than seven days written notice of termination of this guarantee is given by* [Euler] *… then all further liability shall cease as from the date of expiry of this notice or such earlier date*

> *within the period of such notice as the Commissioners may allow except for any liability arising hereunder before that date.*"

In addition, the guarantee also placed a cap on Euler's overall liability.

On 4 May 2020, Euler gave notice of termination to HMRC. That notice was, however, expressed to be effective as of 30 June 2020. On 6 May 2020, HMRC acknowledged receipt of this notice of termination, stating that it was planning to return the guarantee to Euler by 31 August 2020, but adding that HMRC was "… *unable to return it until I am sure that all liabilities covered by it have been paid*." On 8 September 2020, HMRC then made a demand under the guarantee.

That demand related to deferred tax payments which HMRC had unsuccessfully tried to recover from the relevant Mackays company on two occasions. On 15 April 2020, HMRC had sought to debit tax relating to a liability that had been deferred in March 2020. Later, on 15 July 2020, HMRC sought payment of a further sum that had been deferred in June 2020. On both occasions, HMRC went unpaid. HMRC's demand against Euler related to both these liabilities. Euler initially disputed the demand, on the basis that it related to payments that were only deferred after the date of termination of the guarantee. That, though, was not correct because Euler had only terminated the guarantee as of 30 June 2020 (so only the second sum arguably related to the post-termination period). HMRC rejected that point.

In late September 2020, Euler then paid HMRC the full amount requested, and made a demand against Mackays under the indemnity. Mackays declined to pay, and put forward its objections as to why Euler should not have paid HMRC. Those objections included the point that HMRC's demand of 8 September 2020 had come after the effective date of Euler's termination of the guarantee - 30 June 2020.

Euler informed HMRC of Mackays objections. HMRC's response was that Euler's guarantee ought to cover "… *all liabilities accrued by your client during the period your guarantee was active i.e. 01.01.2014 to 30.06.2020*.", explaining that "… *Once notice is given, there are still 7 days when liabilities will be covered by the guarantee - and, all liabilities which arise before "notice+7" will still be covered by the guarantee … The critical point is "did the debt arise during the period covered by the guarantee" – not "did we try to claim against the guarantee during the period covered. Future liability is extinguished on cancellation, not past liability.*"" Notwithstanding this, Mackays declined to indemnify Euler, and so Euler commenced proceedings under the indemnity.

What was the effect of a demand made after the guarantee had been terminated?

The first issue for the Commercial Court to resolve was whether Euler had in fact been liable to pay HMRC notwithstanding the notice of termination of the guarantee. If there was no such liability, then a second issue would fall to be decided: could Euler nevertheless recover amounts paid to HMRC in error (where there was no liability) from Mackays under the indemnity?

As to the first issue, Mackays argument was that Euler's liability under the guarantee only arose once HMRC had made a demand, on 8 September 2020. By then, of course, the guarantee had already been validly terminated.

Natwest v Hardman – Guarantor no longer liable after termination

Mackays relied on the decision of the Court of Appeal in *National Westminster Bank v Hardman* [1988] FLR 302. The guarantee in that case provided that: '*This guarantee shall be a continuing security and shall remain in force …until determined by three months' notice in writing.'* The parties had gone on to agree specifically what liabilities

on the part of the guarantor would survive termination: "… *[B]ut such determination shall not affect the liability of the guarantor for the amount due hereunder at the date of expiration of the notice with interest as herein provided until payment in full.*"

The Court of Appeal held that since no demand had been made at the time of termination, nothing was "*due*" at that time and the guarantor was not in fact liable. In other words, the guarantor did not remain exposed after termination to contingent liabilities where a demand might only be made long after termination, and proceedings against the guarantor might then be issued even later – within the limitation period of six years after such a (late) demand. Such an uncertain exposure was deemed to be inconsistent with the commercial considerations underlying a guarantee.

The Court of Appeal's decision in *Hardman* has been the subject of some criticism, and the Commercial Court in *Euler* treated it as confined to the facts of the particular case – specifically, the wording of the guarantee. The crucial point was that the guarantee in *Hardman* required a demand to have been made prior to termination, so that there was in fact "… *an amount due hereunder* …" (so an amount due by the guarantor to the beneficiary under the guarantee, not an amount due (or a liability) under the contract that was being guaranteed).

BCCI v Simjee – Guarantor remained liable post-termination

In a subsequent decision, *Bank of Credit and Commerce International S.A. v Simjee* [1997] CLC 135 (also reviewed by the Commercial Court in *Euler*), the Court of Appeal reached a different result, namely that the guarantor continued to be liable after termination, based on different contract wording. In *Simjee*, the Court of Appeal gave a helpful explanation of the general principles of English law that apply to guarantees and their terms. English law has no rule against perpetual or open-ended guarantees. In the most straightforward scenario, the surety simply promises that a debtor will discharge a monetary liability, or perform a particular contractual obligation. By way of example, the guarantee may be in respect of the buyer's obligations in an identified contract for sale (chiefly to take delivery and pay the price) or those of the seller (to deliver goods of the contracted-for quality, on time). The guarantor remains liable until that obligation has in fact been properly performed, at which point the guarantor is discharged. It does not matter how long that takes. As Hobhouse LJ noted in *Simjee:*

> *"The liability of the surety is not, as such, qualified in amount or time; a further term is necessary to do that. The liability of the surety to the creditor accrues and becomes actionable as soon as there is a default by the principal."*

Often, however, bonds or guarantees are used where there is not just one specific guaranteed debt or obligation, and the underlying transaction is more complex. There may be a running account, or a series of loans or overdraft facilities that may be subject to periodic repayments by the obligor. In those circumstances, for any guarantee to be satisfactory, it must be a continuing one. The subject matter of the guarantee is then the indebtedness or outstanding performance as it may be from time to time: this will in essence be a security with a floating or changeable subject matter. From the perspective of the guarantor, it would not seem prudent to give such an open-ended guarantee unless there is at least some control over the business of the obligor, lest the indebtedness spirals out of control. In addition, a continuing guarantee must provide some mechanism to establish the liability of the guarantor and also ascertain the amount of that liability. The simplest and most common mechanism is to turn the instrument into an on-demand bond: once a demand is made, the guarantor becomes liable for whatever is outstanding or due from the obligor at that point in time.

Contractually, the guarantor will also want a way of terminating a continuing guarantee. That can be done by allowing the guarantor to give notice of termination effective after a certain period of time. If such a notice is

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served, the beneficiary of the guarantee can then decide whether to make a demand during the period prior to termination. If no demand is made, then the guarantee comes to an end. If a demand is made, then the sum demanded is the final amount for which the guarantor is liable. That was the nature of the guarantee in *Hardman* – but everything of course depends on the drafting.

The guarantee in *Simjee* was drafted so as to lead to a different result. It provided:

> "*This guarantee is to be a continuing security … but may and shall be determined … and the liability hereunder crystallised (except as regards unascertained or contingent liabilities and the interest charges costs and expenses hereinbefore referred to) at the expiration of three months after the receipt by you from the undersigned of notice in writing to determine it …*"

The Court of Appeal concluded that this particular guarantee ceased to be a continuing one as at termination, but instead became a guarantee only of such obligations as remained outstanding at the time of termination. This was because the parties had expressly provided that the guarantee would terminate "… *except as regards unascertained or contingent liabilities* …". A demand could, therefore, still be made, but it had to relate to such obligations of, or amounts due by, the obligor as were still outstanding at the time of termination.

Everything depends on the drafting

That left the question of which type of guarantee Euler had signed up to with HMRC. Here, the parties had not expressly addressed the question of contingent liabilities that might exist as at the date of termination, but they had said this:

> "*… all further liability shall cease as from the date of expiry of this notice or such earlier date within the period of such notice as the Commissioners may allow except for any liability arising hereunder before that date* …"

What did the parties mean when they referred to "… *any liability arising hereunder before* …" the effective date of termination? The answer to that question would depend on the contractual wording chosen by the parties.

The Commercial Court found that taking the commercial background or purpose of Euler's guarantee into account, the instrument covered any potential liability for tax payments that had already been deferred by HRMC *prior* to termination, which Mackays might then fail to repay on the deferred due *after* termination: if Mackays failed to do that after the guarantee had come to an end, HRMC could nonetheless make a demand. The judge found that if HMRC's ability to call on the guarantee were, on the other hand, limited to sums for which a demand was issued before expiry of the termination period - seven days after notice of termination - then HMRC might be unable to recover from Euler sums that were deferred for a period of more than seven days while the guarantee was still valid. To illustrate this, if Euler gave notice of termination on 1 January, to take effect on 8 January, but on 2 January HMRC agreed to defer tax until 9 January, then on Euler's case HMRC would be precluded from relying on the guarantee to recover that deferred payment in the event of a default. The Commercial Court held that this was wrong, as it would amount to depriving HMRC of the benefit of the guarantee for an obligation (to repay deferred tax) that arose while the guarantee was still valid and binding.

Euler had also relied on the fact that, if a demand could still be served after the guarantee had already terminated, then Euler would face an uncertain exposure, over an uncertain period of time. But the judge held that such commercial considerations were not in any way decisive, noting also that there was a statutory framework that governed the deferral of tax: HMRC did not have the power to defer unlimited amounts of tax for an unlimited

period of time, so that Euler's exposure was therefore not wholly open-ended. He also noted that once Mackays failed to pay a deferred liability by the extended due date, one would expect HMRC to waste little time in making a demand under the guarantee. Accordingly, HMRC's demand, made around two months after the guarantee had terminated, was valid.

'Conclusive evidence' clauses and "*manifest error*"

Since Euler had in fact been liable to pay HMRC under the guarantee, and Mackays was therefore liable under the indemnity for an amount properly paid out by Euler, the Commercial Court did not, strictly speaking, have to decide whether Euler could rely on the 'conclusive evidence' clause in the indemnity against Mackays. However, since the parties had made full submissions on the point, the judge addressed it.

Mackays had argued that the clause (stating that a demand by Euler was "… *conclusive evidence of the fact and the aggregate amount of the liability ...*" on the part of Mackays) should be the subject of an implied term, that any such demand should not be subject to a manifest error. The Commercial Court agreed, noting that any demand affected by such an error, or by fraud (which 'unravels everything') on the part of the party making the demand, would not be valid notwithstanding the 'conclusive evidence' clause.

As to what was meant by a manifest or obvious error, the Commercial Court turned to authorities dealing with the validity of expert, or other independent, determinations. In *Veba Oil Supply & Trading GmbH* v *Petrotrade Inc* [2001] EWCA Civ 1832, the Court of Appeal considered a provision in a contract for the sale of gasoil FOB Antwerp, which stated that:

> "*Quantity and quality to be determined by a mutually agreed independent inspector at the loading installation, in the manner customary at such installation. Such determination shall be final and binding for both parties save fraud or manifest error.*"

A separate provision in the contract stated that the density of the gasoil was to be determined using a particular testing method, called D1298. The inspectors tested the gasoil using a different method, D4052. The buyers challenged the inspector's determination on the basis that the wrong testing method had been used, invalidating (they said) the result. The sellers countered that this was not a "*manifest error*" (let alone fraud), so that the inspection certificate was binding on the parties. The Court of Appeal held that the buyers were in the right because the inspector had departed from their instructions – to use testing method D1298. This was not really a question of whether the inspectors had made an error. The parties had agreed to be bound by the outcome of any determination made by using one testing method, D1298. They had not agreed to be bound by a different method. This was a material departure, which meant that the determination was not binding.

Having decided this, the Court of Appeal in *Veba Oil* went on to discuss what might have amounted to a material error (if the inspectors had not departed from their express instructions). In *Dean* v *Prince* [1954] Ch 409, Lord Denning had overturned a determination by a valuer because the expert had erred in principle and used the wrong basis for the valuation. That case was, however, subsequently itself overturned.

The position in English law is thus that absent an express contractual provision, the parties are bound by any mistake in an expert determination to which they have agreed (the only exceptions being fraud, and a failure to follow express and specific instructions). The Court of Appeal in *Veba Oil* held:

> "*Nowadays, if parties wish to contract on the basis that they will not be held to mistakes made by the expert in the course of carrying out his instructions, they must needs include a term like this with*

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> *regard to manifest error. … I would extend the 'definition' of manifest errors as follows: "oversights and blunders so obvious and obviously capable of affecting the determination as to admit of no difference of opinion.*"

In *Euler*, the Commercial Court confirmed that this concept of manifest error also applied to the conclusive evidence in the guarantee with HMRC, but held that HMRC's demand could not in any way be said to have been 'manifestly wrong' (or indeed 'wrong' at all). While 'conclusive evidence' clauses may appear to be harsh on the paying party, they are not against public policy and will be upheld, as the Court of Appeal noted in *Bache & Co (London) Ltd* v *Banque Vernes et Commerciale de Paris* [1973] 2 Lloyd's Rep 437. In the words of Lord Denning:

> "*I would only add this: this commercial practice (of inserting conclusive evidence clauses) is only acceptable because the bankers or brokers who insert them are known to be honest and reliable men of business who are most unlikely to make a mistake. Their standing is so high that their word is to be trusted. So much so that a notice of default given by a bank or a broker must be honoured. It ranks as equivalent to, if not higher than, the certificate of an arbitrator or engineer in a building contract. ... if a banker or broker gives a notice of default in pursuance of a conclusive evidence clause, the guarantor must honour it, leaving any cross-claims by the customer to be adjusted in separate proceedings.*"

How times have changed! However, coming back to our topic, 'conclusive evidence' clauses do not relieve the party making the demand from any obligation to comply strictly with formal requirements for the demand (which might have to adopt specified wording, or might have to be signed by a particular officer). 'Conclusive evidence' clauses will also not operate for the benefit of the receiving party where a demand contains a manifest error, which must be "… *obvious or easily demonstrable without extensive investigation*" (*IIG Capital LLC* v *Van der Merwe* [2007] EWHC 435).

A wider notion of "*manifest error*"?

It is not necessarily the case that the error must have must have existed, or been discoverable, at the time that the demand was made. In *North Shore Ventures Ltd* v *Anstead Holdings Inc* [2011] EWCA Civ 230, the Court of Appeal held that while an allegedly conclusive certificate stating the amount due to be paid by the borrower, for which the guarantor was liable, may appear to have been correct at the time it was issued, subsequent events could still lead to a conclusion that it was manifestly wrong. This was the case even though:

> "*… the certificate* [was stated in the guarantee] *to be conclusive evidence of the amount owing for the time being. In my view that does not follow. It is quite possible for one person to certify the existence of some fact at a particular moment in time which the other person, the recipient of the certificate, cannot verify save after the occurrence of a subsequent event. I can see no reason why the error must be manifest at the time of the certificate.*"

In *North Shore Ventures,* the certificate in question related to an amount due under a loan agreement. The lender certified the amount due by reference to the original version of that agreement, but took no account of the fact that the agreement had subsequently been amended, reducing the outstanding amount. The judge at first instance felt that the conclusive evidence provision saved the certificate, but the Court of Appeal disagreed – even though there was a dispute as to whether the amendment of the loan agreement might have been invalid and unenforceable because of a lack of consideration:

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> "*Subsequent investigation shows in this case that the amount certified was that due under the unvaried Loan Agreement when in fact it should have been limited to the amount due under the Loan Agreement as varied; there was a mismatch between the relevant agreement and the certificate.*"

Interestingly, the subsequent investigation that the guarantor was able to carry out related to a potential defence that the borrower might be able to raise – that the loan agreement had been varied, even though the lender evidently did not consider this to be the case. One might question whether the concept of "*manifest error*" in clauses intended to protect the lender or beneficiary of a guarantee ought to allow the introduction or investigation of potential defences that might be open to the obligor. The decision in *North Shore Ventures* has been the subject of some criticism, and ultimately turns on the wording of the particular certificate. That said, it does arguably widen the concept of 'manifest error'.

Conclusion

Whether a guarantor is discharged immediately upon termination, or whether they might still need to honour a demand that is made after the guarantee has already terminated, will depend on the drafting. It pays (literally) to address the issue of contingent liabilities that may only arise after termination expressly and clearly in the guarantee or bond. In *Euler v Mackays*, the parties had not done that, and the Commercial Court had to decide the precise meaning of the word 'liability' by considering the commercial purpose of the guarantee. Usually, that purpose will be to protect the beneficiary and ensure that the guarantor pays up. Guarantors in particular should therefore pay close attention to the term of the guarantee, and to the nature and extent of any liabilities that may survive termination. Once a demand has been made, guarantors who have accepted a conclusive evidence clause will usually find that they have to pay, and it would be imprudent to rely on advancing any arguable defences that the obligor or borrower may have.

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