# RECENT DEVELOPMENTS UPDATE

# MS Fashions v Bank of Commerce & Credit International Ltd (Guarantees, Principal Obligation Clauses)


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Mr Doyle has given a splendid exposition of the legal issues involved in and arising out of the judgment in this case. His talk, plus the admirable article by Alan Berg to which he referred, probably tell you all you need to know about the relevant legal issues. I feel that there is nothing I need to add to those, even assuming I could.

I propose therefore to restrict myself to one or two comments on what Mr Doyle has described as the policy issues. I concur with his view that decisions are frequently made by reference to policy considerations. The days of rigid application of strict rules are in general long gone, but perhaps with certain unhappy exceptions which I shall come on to.

I am sure that Mr Doyle was not intending to suggest otherwise, but this is not a new development. I remember as a law student wrestling with new developments in the law in areas such as:

- Liability for Nervous Shock
- Trade Union Conspiracy
- Negligent Misrepresentation
- Remoteness of Damage
- Liability in Tort for Financial Loss.

It seemed at the time that cases such as *Hedley Byrne* and *Rookes v Barnard* could only be rationalised by reference to the result the court wanted to achieve. On the basis of authority, a number of those cases could have been decided either way and the court chose to apply those principles which produced the result it wanted.

As part of that development, and largely as a means of achieving that objective, the courts have indeed adopted a new substantive approach, particularly in matters of interpretation, whether of statute or contract.

You will remember the landmark tax cases of *Ramsay v IRC* and *Furniss v Dawson*. The more recent case of *Law Debenture Corporation v Bell Resources* was another example of a decision where the courts declined to accept the uncommercial result which followed from a strict interpretation of the language, and looked through to find what they considered to be the "real" intention of the parties.

However, the courts have not, in my view, adopted a consistent approach. I think that both the *Charge Card* case and *Hammersmith Fulham* are examples of cases where the courts have applied technical rules or narrow interpretations and achieved results which are at odds with commercial sense.

I remember as a young lawyer being captivated by the principle of *Stare Decisis*. It seemed to me to be wonderful that there should be such certainty in the law, with the result that any bright young lawyer (as we all believed ourselves to be) with good analytic skills could ascertain the "right" result to any legal problem by an application of established principles.

I have become older and less rigid, and I hope wiser, since those days and I do now recognise the advantage, even the necessity, for the law to develop in response to changing times.

However, the new flexibility inevitably leads to a loss of certainty. We can no longer be confident that the contracts we draft will be interpreted by the courts so as to give effect to the meaning we intend the words to have. That leads us to seek for greater clarity and greater precision which in turn leads on to more time, more complexity and greater turgidity.

Turning back to the case in hand, Mr Doyle has commented that the case seemed to him to reflect the new drive to get a "commercially sensible and fair result and not to be trapped in technical reasoning". I must say that I have struggled hard to work out what in my own mind constituted a commercially sensible and fair result in this case and I do not think it is an easy process. Nevertheless, I do now agree with Mr Doyle that the result was commercially sensible and fair, but I dissent from Mr Doyle in being of the opinion that, in order to reach the result it wanted, the court did in fact rely on a technicality.

I believe that the main finding in this case, which relates to the status of a guarantor who expresses himself to contract "as principal debtor", is quite at odds with the underlying realities of the transaction.

It is perfectly obvious that, in substance, there was only one principal debtor, namely the company. The loans advanced by the bank were advanced only to the company. The company alone had use of those funds and the company alone had the benefits resulting from the obtaining of those funds.

The individual directors were, in substance, involved merely as sureties. Their substantive obligation was to perform the obligations of the company in the event that the company was unable to do so.

In my view, every commercial lawyer knows that the inclusion of a provision for a guarantor to be liable "as principal debtor" is a mere technicality designed to ensure that the court does not apply equally technical rules, deriving from old cases, the effect of which would be to release the guarantor from liability in circumstances in which, in substance, it would be equally unrealistic for the guarantor to be released.

Applying this substantive approach, I cannot find sympathy with a judgment which produces such a profoundly different result, simply on the basis of the interpretation of a technical provision making the guarantor liable as principal debtor. The individuals were in substance liable as guarantors, and in my view the case should have been decided on the basis of the principles which would be applicable if they were treated as guarantors.

Contrast, for example, the result which would have been achieved had there been no guarantee, but merely a deposit by way of collateral charge (assuming, that is, that such a charge could be created despite the judgment in *Charge Card*). In those circumstances, there would have been no question of set-off. The bank could have claimed the full amount of the debts owed by the company and (subject to what I am just about to say) the directors would have had to prove in the liquidation of the bank for their deposits.

Nevertheless, as I have said, I do consider that the case was rightly decided, although for the wrong reasons. It could have been decided on the basis that a charge of a deposit is no different from a charge of any other property. If, in the circumstances of the case, the directors had charged any property other than a deposit, for example if they had charged CDs issued by another bank, then they would have been entitled to a return of that property, free from the charge, upon the repayment of the loan. I do not see the substantive justification in these circumstances for treating a deposit differently from any other form of property.[1]

As it happens, the Court of Appeal might have decided the case on those grounds. This issue was considered by Dillon LJ in the last paragraph of his judgment, but he stated that, having already decided the case on the "principal debtor" grounds, it was unnecessary for him to consider this additional issue. In my mind, it would have been a much happier result had the case been decided on this ground, rather than turning on a technicality.

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1 I recognise the competing argument, that by agreeing to make a deposit by way of security, rather than charging other property, for example securities, the directors accepted that the bank had the right to use the proceeds of the deposit in the ordinary course of its business, and so should take the risks inherent in that business, including the risk of insolvency.