

Fairstate Limited-v- Atef Sarian (29 November 2010)

The Message: Badly drafted Guarantees may be ineffective.

The Case: The High Court has considered whether deficiencies in the drafting of a personal Guarantee of a property management contract can be cured or not. Fairstate owns a block of 12 residential flats at 22/23 Marylebone High Street, London, W1. In September 2006, it entered into a Management Contract with General Enterprise & Management Limited whereby General Enterprise was entitled to all the rental income in return for it taking over full responsibility for the costs of the building and paying Fairstate a fixed sum each month. The total amount payable in the first year was £120,000 and it increased in subsequent years.

The obligations of General Enterprise were to be guaranteed by its Director, Mr Sarian. He attended at the offices of Fairstate's solicitor, a Mr Salfiti, and signed both the Management Contract and a Guarantee Form as prepared by Mr Salfiti.

Fairstate is claiming a sum of £178,000 under the Management Contract and seeking to recover this amount from Mr Sarian under the Guarantee. However, Mr Sarian claimed the Guarantee was not binding on him as it was unclear and not in the required form.

Pursuant to Section 4 of the Statute of Frauds 1677, no action under a guarantee can be pursued unless there is a written agreement or memorandum signed by the Guarantor or on his behalf. The whole purpose of Section 4 is to prevent disputes as to whether a party had promised to meet the obligations of another party if it defaults.

In order to comply with Section 4, it is also necessary that any written agreement must contain all the material terms and, in particular, it must clearly identify all the relevant parties.

The Guarantee Form that Mr Sarian signed without any legal advice was a very odd document. It was based on the terms of a bank guarantee whereby a third party guarantees the obligations of the customer. It had not been amended to make it suitable for identifying or guaranteeing the obligations under the Management Contract. Moreover, to add to the confusion, the names of the parties had been transposed so that Mr Sarian was guaranteeing to himself the liabilities of Fairstate rather than him guaranteeing to Fairstate the liabilities of General Enterprise.

Mr Sarian claimed he had been misled and had not even known he was signing a Guarantee but the Court rejected his evidence in this respect so attention focussed entirely on whether the Guarantee was compliant with Section 4 or not?

Mr Sarian claimed it was non-compliant as it did not correctly identify the parties or the obligations being guaranteed and was drafted so as to be inapplicable to anything other than a banking transaction. He said the defects were so great that could not be rectified by seeking to construe it in a way that accorded with what was intended to have been agreed at the time.

Fairstate argued that it was plain what the parties had intended to achieve and who was to be the creditor, debtor, and guarantor and that there was nothing special about a Guarantee which prevented a Court seeking to interpret it in a constructive way or rectifying it to correct any manifest error.

The Court accepted it could apply the same principles as to construction and rectification of a Guarantee as apply to any commercial contract. It could rely on other evidence to establish who the parties were but would need to exercise particular care where there was a dispute as to what had been agreed so that it should be slow to deprive any defendant of the statutory defence under Section 4.

However, whilst accepting it could correctly identify the parties, the Court held that the corrections and additions it would have to make to the wording of the Guarantee so as to apply it to the Management Contract were so large that it would not be interpreting it to give effect to the parties' perceived intention but re-writing it almost completely so that the parties had a new and different Guarantee. Accordingly, the Court held the Guarantee to be ineffective and beyond any form of purposive construction or rectification.

This is a case where the party that was not legally advised actually benefitted as, if the mistakes in the form of the Guarantee had been corrected before it was signed, Mr Sarian would have been on the hook.