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Guarantees: How indulgent is an indulgence clause?

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A guarantor's liability under a guarantee is dependent on the underlying obligation, usually the loan agreement. Any amendment to the principal obligation could inadvertently discharge the guarantor. This could happen regardless whether:

- the guarantor has agreed in advance to amendments being made without its consent (commonly known as an "indulgence clause"); or
- the guarantor was, at the time, aware of the amendments being made.

The High Court in *Maxted and another v Investec Bank Plc* [2017] EWHC 1997 (Ch) considered the circumstances in which a guarantor's liability under a guarantee might be discharged by changes to the principal obligations between the lender and the borrower.

Mr Maxted, along with a co-director, was a guarantor of loans made by Investec Bank to a group of companies. The guarantees were capped at €450,000 plus interest, costs and expenses. The guarantees also included a clause stating that the guarantee would not be discharged by "any variation or amendment of any agreement between the bank and the debtors".

The loan agreements were amended twice to extend the term of the loans; the first amendment also included a roll up of the interest on the loans. The term of the loans were further extended, and the guarantors signed a statement confirming that the bank could continue to rely on the guarantees in respect of the loans. The guarantors also signed a confirmation that they had declined to seek independent legal advice (**Waiver**).

When the bank made demands under the guarantees, the guarantors claimed that the guarantees had been discharged by variations to the loan agreements which were outside the scope of the consent to variation clause in the guarantee. They also claimed that they had not consented to the variations despite having signed the Waiver.

The guarantors' claim was rejected by the Court, which held (amongst other things) that:

- the variations made to the loan agreements were within the scope of the consent clause; and
- consent had been given to the variations by the act of signing the Waiver, in any event.

The case of *Triodos Bank NV v Dobbs* [2005] EWCA Civ 630 serves as a reminder of how far lenders should go when making changes to the underlying obligations. Like Maxted, Triodos involved a guarantee given by a

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director. The Court of Appeal held that a variation would discharge a guarantee if the variation amounted to a new agreement, for example:

- finance was being provided for a different purpose to the original loan;
- it provides for a much larger sum than the original loan (regardless of whether the guarantor's liability remains capped; the greater the loan obligation the greater the risk of defaulting on its payments, thereby increasing the risk of the guarantee being called); or
- the new loan was substantially different to the original loan and was not within the scope of the variation anticipated by the original loan agreements.

These are all sensible principles. Uncertainties may still arise, however, around the degree of change from the original obligations.

Indulgence clauses do not provide absolute protection. In practice, most lenders will continue to act with caution and will not rely totally on indulgence clauses. Most lenders will seek the consent and confirmation of the guarantor and any third party provider of security when agreeing to any variation with the borrower.

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