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Points for property professionals 1

Undue influence in lease guarantees

This is the first of a short series of notes on non-property legal points relevant to property lawyers and others in the property industry.

Landlords of commercial premises often require personal guarantees of the tenant's obligations. But landlords may not be aware that a guarantee procured by "undue influence" by a third party, even without the landlord's knowledge, may be unenforceable. This applies to guarantees of leases just as it does to bank guarantees, as the landlords found to their cost in the recent case of *Trustees of Beardsley Theobalds Retirement Benefit Scheme v Yardley*.

For years now, banks have been aware they need to make sure that guarantors get independent advice where there is a manifest disadvantage to the guarantor in giving the guarantee: *Royal Bank of Scotland v Etridge*. The bank loses out if the guarantee is procured by fraud or undue influence (for instance of a husband or boss), if the bank should have taken steps to ensure that there was no undue influence. Usually it does that by requiring separate legal advice to the guarantor. But landlords have typically not taken the same approach.

In *Beardsley Theobalds* the guarantor was an employee of the tenant company. A director falsely represented to the landlord that the employee was a director, and the landlord did not check. The director then got the employee to sign the lease without telling him what it was, and only showing him the signature page.

The judge held that the guarantee was unenforceable. It had been procured by undue influence, and the landlords had not taken precautions against that possibility, such as insisting on independent legal advice. The landlords had "constructive knowledge" of the undue influence, because the landlord was aware of the tenant's precarious financial position: it was obvious that giving the guarantee was disadvantageous to the guarantor, so the landlord should have been aware of the risk that the guarantor was subject to undue influence. The landlord should also have been aware (though the judge's reasoning for this is not stated) because the landlord could have checked whether the guarantor was a director. "They should therefore have checked that the proposed guarantor was financially sound, aware of the risks being undertaken

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and in full agreement with the proposal that he was to guarantee the rent for a fifteen-year period. The guarantor should have been asked to acknowledge in writing that he was fully in agreement to become a guarantor and had been made aware of the risks of signing the guarantee. He should also have provided, through [the tenant], a signed acknowledgement from a solicitor that he had been given appropriate advice before agreeing to sign or a signed waiver of the need to take such advice."

Unusually, the judge also accepted a defence of "non est factum" (not my deed), available only when the person signing is completely unaware of the nature of the document he is signing. He also allowed a defence to the effect that the guarantor had not authorised the delivery of the deed in escrow, under which it awaited the satisfaction of conditions for two months, which the tenant struggled to fulfil. This last point has wider implications, since parties and their solicitors often fail to consider the authority of parties to deliver deeds and the need for their agreement to any escrow.

The risks to a landlord – or anyone else relying on a personal guarantee - can be reduced by:

- placing a clear warning just above the signature space about the nature of the guarantee and the need for legal advice
- putting the guarantee in a separate document (though this could have other implications if it is to benefit the landlord's successors in title)
- making sure that the guarantor has a clear financial interest in the tenant company so that the guarantee is not manifestly disadvantageous to the guarantor
- treating the guarantor as a separate party and not assuming that the tenant or its solicitor has authority on behalf of the guarantor, eg for completion arrangements
- checking the identity, relationship and financial standing of the guarantor, and his signature
- insisting that the guarantor gets independent legal advice, providing information about the nature of the liabilities to the legal adviser and getting written confirmation from the legal adviser that he has given the advice.

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