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Bulletins

Beware the Promise “To Procure”: The Risk of Giving an Inadvertent Guarantee in English Law Contracts

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Overview

Two recent UK decisions have highlighted the risk of giving an inadvertent guarantee in a contract. The cases turned on the use of the words “procure” and “ensure”, and the court held that a promise by one party to “procure” or “ensure” that a third party does something (e.g., where one party to a software development contract agrees to procure that its subcontractors will comply with certain programming procedures or where one group company agrees to ensure that its affiliate properly performs certain services under an outsourcing contract) may in fact amount to a guarantee. This can lead to serious consequences. In particular, it might increase the scope of the “guarantor’s” anticipated liability or even put it in default of its financing arrangements.

To avoid this risk, parties should try to avoid using words that may be misconstrued, such as “procure” and “ensure”. Where the intention is that one party will simply perform an administrative function to help arrange for a third party to satisfy a specified liability on its own behalf, then it is best to state this expressly, rather than rely on looser language.

Background

The two cases in question are *Nearfield Ltd v Lincoln Nominees Ltd* and *Associated British Ports v Ferryways NV and MSC Belgium NV*.

In *Nearfield*, the High Court found that a promise by a company to “procure the payment” of a loan made to an affiliated company amounted to a guarantee of that loan. In reaching its decision, the High Court rejected the company’s argument that the obligation “to procure” was really a limited administrative obligation to facilitate the repayment. Instead, the High Court said that the normal meaning of the word “procure” is to “see to it” and, therefore, the first company had promised to “see to it” that its affiliate repaid the loan. In other words, the first company was guaranteeing the repayment.

In *Associated British Ports*, the Court of Appeal had to consider the proper construction of a contractual promise by MSC to ensure that its affiliate Ferryways (1) had sufficient funds and other resources to fulfil and meet its duties

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and liabilities under an agreement with Associated British Ports and (2) did promptly fulfil and meet all such duties and liabilities. In interpreting this promise, the Court of Appeal adopted a similar approach to that of the High Court in *Nearfield*, saying that it created a “see to it” obligation and that, therefore, it was properly construed as a guarantee. In other words, MSC would “see to it” that Ferryways would fulfil its liabilities and, therefore, its own liability would only be triggered if Ferryways failed to do so. The secondary nature of its liability marked MSC as a guarantor (i.e., a guarantee will only bite if an underlying obligation is not discharged).

Decision & Implications

The clear message from these two decisions is that a promise by a company to “procure” or to “ensure” that a third party satisfies a specified liability may amount to a guarantee of that liability. The practical consequence of this is that a company may be guaranteeing liabilities without realising it. For example, within a small corporate group where group companies often act as a collective rather than as individual entities, it may not be unusual for one group company to promise to ensure that another group company performs certain obligations. In so doing, the first group company may, without realising it, be guaranteeing the performance of those obligations.

The implications of this can be very serious:

- Firstly, the company may be taking on more risk than it has been anticipating. The company may think that its only obligation is to help arrange for the third party to satisfy the specified liability on its own behalf. However, if the promise is construed as a guarantee, the company may in fact be required to satisfy the liability itself if the third party is unable to do so. The situation may be further aggravated by the fact that the company is unlikely to have the contractual protections that it would normally seek when giving a guarantee (e.g., a right to approve any variations to the guaranteed liability).
- Secondly, it may make the company’s promise unenforceable and undermine the entire contractual arrangement of which it forms a part. In particular:
 - Under the Statute of Frauds 1677, a guarantee will be unenforceable unless it is in writing and signed by the guarantor. As such, where a verbal promise “to procure” is really a guarantee, it may not be enforceable. When dealing with a small company group, it may not be uncommon for a representative of the head company to promise verbally to back up the obligations of its subsidiaries. A verbal promise is difficult to enforce at the best of times, but it will be even more difficult if the promise is construed as a guarantee and, therefore, falls foul of the Statute of Frauds.
 - The company’s constitution may restrict the company’s power to give guarantees. For example, board or shareholder approval may be required for the company to give a guarantee. If the proper approval has not been obtained, then the company may be able to set aside the guarantee (though usually it will only be able to do so where the counterparty has acted in bad faith).
- Thirdly, the guarantee might upset the company’s finance arrangements. For example, the company’s loan agreements may be subject to a restrictive covenant prohibiting the company from giving any guarantees without the financier’s prior consent. In this case, if the company has inadvertently breached the covenant by giving a guarantee, the financier may claim that the company is in default and demand early repayment of the loan. More likely, the financier will seize the opportunity to renegotiate the terms of the loan, using the threat of early repayment as leverage.

For these reasons, companies should take care when, as they may often be asked to do in a complex IT or outsourcing transaction, assuming any responsibility for a third-party liability. Careful attention must be paid to the drafting, in particular when it comes to the use of words such as “procure” and “ensure”, so that the extent and nature of the company’s responsibility cannot be misinterpreted.