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LEGAL ANALYSIS OF VALIDITY OF A SURETYSHIP AGREEMENT

Summary

In order the contracts to be binding and engender legal consequences, firstly, they must be concluded in compliance with formal requirements set forth in the legislation. A suretyship agreement is also a contractual obligation. Taking into account its unilateral and gratuitous nature, the suretyship contract can result with onerous circumstances for the surety. That is why, validity conditions of the suretyship agreement pursue the aim to preserve legitimate interests and economic situation of the surety. The provision of them make the surety comprehend the seriousness of his engagement. This article illustrates the analysis of the essential terms of the suretyship agreement to be valid in comparison with foreign legal systems.

Key words: *suretyship agreement, a security device, conditions of validity, existence of a main obligation, written form, spouse's consent.*

Introduction

The suretyship is one of the types of personal security devices, according to which the surety undertakes to fulfill an obligation of the principal debtor, in case of non-performance. Pursuant to the requirements of the legislation, suretyship is considered a contractual obligation. As a result, the establishment and validity of this agreement demand the existence of all the conditions necessary for the emergence and validity of any contractual obligation.

In addition to the general validity conditions of the contracts, some special terms must be stipulated in order to deem the suretyship contract valid. The purpose of the validity requirements is to prevent the surety from undertaking the obligation without thinking properly. There are distinct factors required for the validity of the suretyship agreement in various legal systems.

I.The existence of a valid main obligation. In Azerbaijani legislation, the contract of suretyship is envisaged as a way of securing performance of the main obligation. The article 460.3 states that the invalidity of the primary obligation shall result in the invalidity of the obligation assuring thereof, unless otherwise is prescribed by this Code. [1, art. 460.3]

Under the decision "on interpretation of Articles 470.1, 470.2 and 471 of the Civil Code of the Republic of Azerbaijan", dated 4 September 2012, the Plenum of the Constitutional Court of Azerbaijan Republic notes that in such contract the determination or the possibility of determination of the main obligation has to be fixed. Accordingly, in the contract of suretyship must be specified under which main contract the suretyship is formed (with the indication of the parties, date and number of the contract) and the indication on limits of the main obligation (obligation of the debtor in front of the creditor). [2]

The establishment, sustainability and termination of the suretyship agreement depends on the main obligation. Because of the accessory nature of the warranty contract, in case of invalidity of the primary obligation, suretyship is also considered invalid. The scope of the suretyship is limited to the the main obligation. [5, p.5]

Article 492 of Swiss Code of Obligations also states analogical relation of the suretyship to the primary obligation. A contract of suretyship presupposes the existence of a valid primary obligation. [6, art.492]

The surety agreement shall be considered invalid, in case of emanation of the primary obligation from a void transaction due to illegality, immorality, informality or incapacity. In Coutts and Co. v. Browne-Lecky and Others (1946), two sureties had furnished security for the amount of an overdraft granted to the first defendant who was a minor. All the parties were aware that the debtor was an infant. In case of non-performance, the plaintiffs sued them for recovering money. J.Oliver held that pursuant to section 1 of the Infants Relief Act, the loan to the debtor was deemed "absolutely void". So, there was no liability of the minor. Subsequently, as there was no primary obligation enforceable, taking into account the accessory nature of suretyship, the sureties were not liable either, as the suretyship agreement was also invalid. [7, p.40]

On the contrary to this approach, a different attitude is stated in both Turkish and Swiss legislation. According to this, a person standing surety for fulfillment of an obligation arising from a transaction that is

not binding on the principal debtor, because of mistake or incapacity is held liable for such obligation, if he was aware of the factor violating the contract at the time of conclusion. [6, art.492]

Suretyship for future and conditional obligations. It is not compulsory to have the main obligation at the time of conclusion of suretyship. The legislature of civil law systems also envisages the possibility of concluding suretyship for the obligations appearing in the future. In the article 470.2 of Azerbaijani Civil Code it is stated that the warranty agreement can be also entered into for the assurance of an obligation appearing in future. [1, art.470.2]

With regards to the decision, dated 4 September 2012 of the Plenum of Constitutional Court of the Republic of Azerbaijan, the requirements for the warranty agreement for the future obligations are as following:

a)This agreement can be concluded by the parties, if they consent to all essential terms of the contract in the required form;

b) the provision "security of the obligation appearing in the future" has to be comprehended as becoming surety for a future obligation relating to the main debt which was concurred before;

c) the mutual rights and duties of the parties of the warranty agreement ensuring the obligation appearing in the future are formed not from the moment of conclusion of such contract, but from the moment of emergence of the main obligation which is subject to security by the surety. [2] Pursuant to it, the rights and duties of the parties of the suretyship agreement are delayed until the establishment moment of the obligation appearing in future. Subsequently, this allows us to deduce that the suretyship contract concluded for assurance of the future obligation has some similarities with the transaction concluded with suspensive condition.

According to the decision of 31 May 2018 of the Plenum of Constitutional Court of the Republic of Azerbaijan, the credit line agreement defines the general terms of the mutual obligation relationship in the future. So, warranty agreement may be concluded in order to secure the fulfillment of the obligations determined in the credit line transaction. The essential terms of the credit line agreement (amount of payment, date, interest rate, currency) must be unequivocal and clearly stated to conclude the suretyship. The surety's consent regarding the interest rate must be given in the concluded credit contracts, in case of non-indication of the interest rate in the credit line agreement. Since the circumstances enabling the possibility of determination of the amount of the surety's liability for a future obligation are deemed essential terms, they will be precisely stipulated in the credit line agreement. [3]

Under the decision, dated 4 September 2012 of the Plenum of Constitutional Court, it is noted that besides the current and future main obligations, security of the obligations emerging from the contracts signed under the suspensive or canceling condition with the suretyship agreement is also possible, and the latter one can be concluded with a certain condition. The example of suspensive conditions that make suretyship enforceable is conclusion of security contracts by the creditor with the debtor or the third parties (for instance, the mortgage contract). The termination or invalidity of other security contracts signed between the creditor and the debtor can be stipulated in the suretyship agreement as canceling condition. [2]

In other countries' legal system the possibility of standing surety for future and conditional obligations is also envisaged. As the nature of the suretyship relationship is a lasting obligation, the contract is considered valid, even if the principal debtor temporarily has no obligations to perform. German law requires the obligation appearing in the future to be determinable, whereas in Polish law the secured debt should be defined by a fixed sum in advance. [8, 341]

II. Form of the suretyship contract. Article 471 of the Civil Code stipulates imperative rule concerning the form of the contract. It states that the suretyship agreement must be made in writing. The violation of the written form shall result in the nullity of the agreement. [1, art.471]

In the decision of the Plenum of Constitutional Court "on interpretation of Articles 470.1, 470.2 and 471 of the Civil Code", the requirement of the written form has been substantiated. Pursuant to it, by means of the provision of concluding the warranty agreement in writing in the legislation, the unconscious undertaking of the obligation by the surety is prevented. The stipulation of the concrete amount of the obligation provided with suretyship in the written agreement is deemed a significant term and aims to protect legitimate interests of the surety. [2]

According to the decision of 14 July 2015 of the Plenum of Constitutional Court "on interpretation of some provisions of Article 460.1 of the Civil Code", a significant clause was determined for review of suretyship cases in court disputes. Under several circumstances "warranty letters" which were presented by the surety unilaterally were accepted as suretyship agreement until certain period of time. The Plenum of Constitutional Court noted that firstly, the nature of unilateral transactions, suretyship agreement, essential

terms and the form of the contract must be clarified in order to decide whether the warranty letters given by third party can take place as other way of security of performance of the obligation or not. After analysing the special characteristics of the suretyship agreement, Plenum of Constitutional Court defined that regarding the requirements of the articles 386, 470, 471 of the Civil Code, suretyship agreement can only be admissible as a way of security of fulfillment of the principal obligation, if it is made in the written form between parties. Actually, pursuing the aim to ensure stability of civil circulation concerning suretyship, it was fixed that the legal attitude of Constitutional Court would refer to the relations only appearing after this decision. [4]

According to the article 766 of German Civil Code, the declaration of suretyship must be made in writing, otherwise it shall be deemed invalid. This requirement is met when the surety signs a written document by hand. Furthermore, the hand-signed declaration of will has to be sent to the addressee in that form. That is why, the written form requirement will not be implemented duly, for example, when signed declaration is delivered only by telefax, on grounds that the creditor only receives a copy of this document, whereas the original one remains in the surety's possession. Pursuant to the second sentence of the same article, declaration of suretyship made in electronic form is not admissible and considered void. [8, p.337-339]

There was a controversy whether or not a blank suretyship document could meet the validity condition until nineties, but now The Federal Supreme Court helds the position that the authorization of other person to declare suretyship must also be evidenced by writing. When the surety presents signed blank form to the principal and the latter fills in the essential terms, then "completion authorization" does not meet the form requirement of the article 766, because suretyship agreement doesn't contain main conditions consented by the surety. Consequently, such a tacit power of attorney is deemed null. However, the surety is held liable, if the creditor can not be aware that the content of document has been written by other person than the surety. This rule is interpreted independently of whether or not the suretyship agreement coincides with the surety's will as a result. [5, p.58]

German Commercial Code contains an express exception to the written form requirement. A promise by the third party to stand surety does not have to be in writing, if it is given by a merchant in the ordinary course of his business and the legal act is a commercial transaction. The formal defect concerning the form of the contract is cured, in case the surety discharges the primary obligation. [9, p.28]

In Turkish legal system the written form requirement is also deemed a validity condition. According to the article 583 of Turkish Code of Obligations N6098, suretyship agreement is invalid, as long as the surety doesn't make a written declaration and indicate the date of the contract and the maximum amount he is liable for. The formal conditions of suretyship agreement shall also apply to the subsequent amendments that increase the total liability of the surety. [10, art.583]

By enforcement of this code, a new requirement "handwriting" which wasn't indicated in the former legislation was stated concerning the content of the document. Pursuant to this new term, the surety shall draft with his own handwriting a) maximum amount of the secured obligation, b) the date of suretyship and c) in case of joint suretyship, undertaking with any expression that enables to recognize him as a joint surety. By indicating these terms in handwriting, the determination of surety's liability by means of signing a white document which is filled in by another person has become impossible. [5, p.41]

In suretyship agreement the maximum sum of the secured debt can be fixed both in numbers and letters. The document should contain the sum in currency, nevertheless, no obstacle exists to indicate the amount in foreign currency. The amount of obligation surety is liable for consists not only of the main debt, but also collateral debts such as, interest and expenses. The fundamental reason to illustrate the date in the contract is applicability of the rule in the article 589, stipulating in the absence of the agreement to the contrary, the surety is only liable for the debts appearing after conclusion of such contract. The requirement for separate expression of joint suretyship in the document derives from its onerous nature which makes the surety and the debtor equal in front of the creditor's demands. [5, p.43-45]

In the article 493 of Swiss Code of Obligations exactly the same written form is stated for a valid contract, however, in comparison with the rules mentioned in Turkish legislation, various forms of writing are envisaged for sureties who are natural persons and legal entities respectively. Initially, when the surety is a private individual, his declaration should additionally be made in the form of a public deed. The official form requirement is only for natural persons and while the total amount is more than 2,000 francs. Secondly, if the amount of obligation does not exceed the amount of 2,000 francs, stating in the surety document the maximum sum of the secured debt and the existence of joint liability, if any, in his own handwriting is ample. Thirdly, surety contracts in favor of the Confederation or a canton for the execution of public law obligations merely require the simple written form and a provision of the amount of debt in the surety bond.

The mitigation of the form rules regarding suretyship for public services can be construed as a legal policy, as it results with making the process easier. Finally, there is no additional requirement for legal entities, the simple written declaration is sufficient for validity. [11, p.128]

In English legislation, the written form is not a formal requirement. It means that an oral contract of surety is not void, but merely affects enforceability, the extent it may be proved. In the section 4 of the Statute of Frauds 1677, it is stipulated that no action shall be brought to charge the defendant upon any special promise to answer for the debt, default, or miscarriage of another person ... unless the agreement or some memorandum or note thereof, shall be in writing and signed. [12, p.17]

This provision serves two purposes: First, evidentiary, we mentioned it above, second, cautionary, which enables to emphasize the significance of surety's act, to dissuade him from giving his commitment heedlessly, assuming that there is only a remote opportunity that the principal debtor will not perform his obligation.

The United States legal approach to this issue is also the same. Statute does not render oral promise to fulfill obligation of another null, however, constitutes to avoid enforcement of the promise by suit. Furthermore, surety can't recover the money back he paid willingly or coercively in relation with his oral promise. In an early Massachusetts case, Nelson v. Boynton (1841), surety contract concluded with "main purpose" rule wasn't deemed within the Statute. It stated that in case the leading object of the surety is to subserve his own purposes, regardless the effect is to perform the obligation of another, his promise is not within the statute, since he is obviously trying to promote his own interests and has obtained something more or less beneficial to him. [13, p.210]

Article 3038 of Louisiana Civil Code states that suretyship is made in writing and must be express. Not every written agreement concerning the debt of a third person is considered suretyship. In order to deem the agreement suretyship, it should expressly contain a promise to accommodate another. This statement is unanimously construed as an undertaking to stand surety can't be tacitly meant from a surety's conduct. Colloquially, if the contract can't be interpreted as "if he doesn't pay, I will," then it will not be sufficient to call the agreement suretyship. For example, in the case of *Ball Marketing Enterprise v. Rainbow Tomato Co*., there was an open account between Ball Marketing-creditor, and Rainbow Tomato-debtor. Ball Marketing sued Plant Industries, Inc., because of a letter to the former regarding Rainbow's debt. Ball alleged that Plant had undertaken obligation as a surety for Rainbow's debt, since the letter stated: "This will verify our understanding with you that Plant will take such steps are important to assure payment to you by Rainbow". The Court held that this language was not ample to make Plant a surety for Rainbow's obligation, the words "taking necessary steps" were not tantamount to an express promise. The letter didn't furnish the obligation by Plant to pay, in case of non-performance by Rainbow. It can be construed merely as a statement that Plant consented to encourage Rainbow to pay, but did not indicate his intention to ensure that the creditor will be paid. [14, p.571]

III. Spouse's consent. Although this term is not envisaged in our legislation, in several legal systems, this special restriction is prescribed concerning the capacity of a married person to furnish security.

In new Turkish Code of Obligations No.6098, the article 584 is dedicated to the novel term "spousal approval" which is taken into consideration as a validity condition. According to the decision of 26 December 2013 of Turkish Constitutional Court, the goal of the restriction which came in force by this article is firstly, the protection of the economic existence of family, as a result, the peace of this family. Subsequently, it is obvious that the interference of this provision by means of preventing extinction of wealth (possessions) of family by one of the spouses is not against the democratic society system, taking into account that it is directed to guarantee the future of marital unity in compliance with the 41st article of the Constitution. On the other hand, with this limitation, the aim of prevention from the conducts which can establish venture for the future of the family and avoidance of undesirable misunderstanding is pursued. It is undoubtedly, beneficial for the public order. [15, p.78]

Pursuant to the article 584 of above-mentioned code, a married person may enter into the suretyship contract only with the written consent of his spouse. The spousal approval shall be granted in advance or at the latest, simultaneously with conclusion of the contract. [10, art.584]

The spouse's consent is not required, when the subsequent amendments to the suretyship agreement do not increase the secured amount of obligation, transform ordinary suretyship into joint suretyship or significantly decrease the scope of the surety's security.

The simple written form of the consent is ample. As the spouse signs the suretyship document, it meets this requirement. The legislation doesn't make a difference between a husband and a wife. Both of them should get the other's assent in order to stand a surety. Any failure on receiving the consent of the other spouse will result in

nullity and in case of obtaining approval after the moment of the conclusion of the contract, it shall not make the contract binding. TCO states the presence of two circumstances when there is no need to ask for consent: 1) the court decision of split; 2) legal right to live separately. Also there is an exception to the spousal approval in relation with the performance of business and trade:

a) suretyship regarding business by the owner of enterprise registered at the trade registry;

b) suretyship regarding a company by the partner or manager of the commercial enterprise;

c) suretyship regarding professional activity by craftsmen and tradesmen registered at craft and related trades workers registry;

d) suretyship regarding the loans used by cooperatives of agricultural credit, agricultural sales and craftsmen and tradesmen credit with public institutions. [15, p.92-95]

In an English case Barclays Bank Plc. v. O'Brien (1994) was touched to this issue, it was interpreted that a high percentage of privately owned income is invested in the matrimonial home. Because of the equality of the sexes, most of matrimonial homes are in the joint names of both spouses. So, regarding the business enterprises of one of them, this home has become a principal source of security device. The execution of such security demands both spouses' consent. [16, p.3]

Conclusion

Summarizing all the above-mentioned conditions and approaches, we can say that it is significant for the suretyship contract to meet these requirements to be legally binding. Various validity conditions are stated in different legal systems, nevertheless the violation of one of them is sufficient to deem the surety agreement void. Because of the accessory feature of suretyship, a main obligation has to exist to determine the scope of the surety's liability, it must be evidenced by writing to make the contract enforceable. These terms serve a purpose to prevent a surety from taking risks unwisely in suretyship relations.

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