When an application for an advance can’t offer any tangible security, the banker may rely on personal guarantees to protect himself against loss on advances or over draft to the applicant.

**Definition:**

Section 126 of the Contract Act, 1872, defines ‘guarantee’ as “A contract to perform the promise, or discharge the liability, of a third person, in case of his default”. The same Section further explains that “A guarantee may be either oral or written”. Therefore, a guarantee is a promise by one person, called the ‘guarantor’ or ‘surety’ to another for answering the present or future debts of a second person called the ‘principal debtor’. Though the law has allowed an oral guarantee, the practice of bankers has made it obligatory agents. It has also been necessary to make it enforceable in a court of law. There is no formal shape, but it must be written so as to show that a contract of guarantee has been entered into. Therefore, it should contain the names of the parties and the essential terms of the contract, including the consideration in support of the contract.

**Capacity of Guarantee:**

Every person who is competent to contract in accordance with Section II of the Contract Act, 1872, is qualified to enter into a contract of guarantee. Thus, it is implied that the guarantor is of the age of majority and is of sound mind and is authorized to enter into a contract. A married woman may enter into a guarantee, but it is a general practice with some bankers to arrange for a guarantee by a woman under the guidance of her solicitor so that later on she may not deny her liability.

**Company as Guarantor:**

Bankers must be very cautious in accepting guarantees of registered companies, for in the ordinary course of business, a company is not authorized to give a guarantee. Under Section 190 of the Companies Act, 1913, a company is prohibited to give guarantee against its Director’s borrowing. Before accepting a company as a guarantor, the banker must see whether the Articles and the Memorandum of Association have allowed him to do so.

The guarantee of a registered company should be given on behalf of the company and under its seal, and under the hands of a Director or some other person authorized to do so by a resolution of the Board of Directors of the company.

**Firm as Guarantor:**

A person is not supposed to bind his co-partners by guarantees, but he can do so if:

1. Giving guarantee is a part of the ordinary course of the business of the firm:
2. The partner has expressed has authority of his co-partners to give such a guarantee.

**Guarantee by two or more persons:**

A guarantee maybe executed by two or more person: and the liability of the guarantors would then be joint and several. Therefore, such a guarantee should be duly signed by all the guarantors.

**Minor as Guarantor:**

The contract Act, 1872, has disqualified a minor from entering into a contract except the one for his necessities. Therefore, he can’t be a guarantor. Moreover, even if the minor attains the age of majority, it will not cure the defect, because, the contract of guarantee is not included an all such contracts which are binding on the minor’s attaining his majority. Bankers should not, therefore, accept any guarantee executed by a minor independently or jointly with a major.

**Kind of Guarantees:**

There are two kinds of guarantees:

1. Specific
2. Continuing

When the guarantee refers to a specified transaction only, it is called a “Specific Guarantee”. Once the repayment of the entire amount is made, it becomes void.

A guarantee may be worded so as to cover, within an agreed limit, the fluctuating debit balance of an account at an time during the continuance of guarantee. Such a guarantee is known as “Continuing Guarantee”. Section 38 of partnership Act lays down that “A Continuing guarantee given to a firm or to a third party in respect of the transactions of a firm, is, in the absence of agreement to the contrary, revoked as to future transactions from the date of any change in the constitution of the firm”. According to Section 129 of the Contract Act, “A guarantee, which extends to a series of transaction, is called “Continuing guarantee”. Such a guarantee is revoked when there is a change in the constitution of the firm by death, insolvency or retirement of a partner or by admittance of a new partner”.

**Consideration:**

Like other contracts, the contract of guarantee must also be backed by ‘consideration’. Section 127 of the Contract Act, 1872, defines ‘consideration’. For a guarantee as under:

“Anything done, or any promise made, for the benefit of the principal debtor may be a sufficient consideration to the surety for giving the guarantee”.

The above Section clearly indicates that consideration should not necessarily be something done for the benefit of the principal is also sufficient to make a valid contract.

**Rights of a Guarantor:**

If he does not expressly waive them, a guarantor has the following rights:

1. During the validity of the guarantee, a guarantor has the right to ask the creditor to inform him of the amount for which he is liable under the terms of guarantee. However, with due respect to the confidential nature of banker-customer relationship, the banker should not supply the guarantor with a copy of the customer’s account, unless an express consent has been obtained from the customer. The banker may, on the other hand, give information only to the extent of the guarantor’s present liability. If due debts exceed the amount of guarantee, the banker should merely inform the guarantor that he is liable for the full amount of the guarantee.
2. If the principal can’t pay, and is adjuscated a bankrupt, the guarantor is entitled to prove on his = = = = = =
3. The guarantor may himself pay the principal debtor’s debt and enforce his remedies against the principal debtor. In such a situation he becomes the creditors = = = = = = = = = =
4. He may revoke the guarantee after giving sufficient notice. All outstanding cheques presented after the receipt of notice can only be paid at the banker’s risk. In order to safeguard against these risks. The bankers include an express provision requiring the guarantors to give notice of a specified period before terminating their liability on the guarantees.
5. When the guarantor has discharged his liability under the guarantee. He not only succeeds to the banker’s rights and equities, but is also entitled to benefit from all or part of the principal debtor’s securities hekd by the banker as cover for the guaranteed debts.

**Rights of the Creditor:**

The creditor has the following generally accepted rights:

1. If the principal debtor defaults, the creditor can recover the amount due under the guarantee from the guarantor.
2. The creditor is entitled to sue the guarantor even if the advance made to the principal debtor has become time-barred.
3. The law of Limitation does not apply to a guarantee and remains operative in the case of principal debtor.
4. A banker can sue the principal debtor after filing a case against a guarantor; but it should be done within the period of limitation.

**Concealment on Guarantee:**

Section 143 of the Contract Act, 1872, says. “Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid”.

Thus, it will be seen that the basis of the Contract of guarantee is not on the ideal of atmost faith. The action, however, implies that intentional concealment is a material circumstance to make a contract of guarantee invalid.

**Guarantee by misrepresentation:**

It is necessary that all the parties to a contract should give their free consent; but when the guarantee is obtained by means of misrepresentation on a material part of the transaction, no such free consent can be said to exist. Thus, any misrepresentation would entitle the guarantor to rescind.

Bankers are not likely to accept a deliberately false statement. Therefore, in discussion of negotiation with the guarantor to give him a chance, the banker should not, even casually, say anything that would mislead the would-be guarantor.

**Demand for Payment:**

When the principal debtor is in default, it is not necessary for the banker to sue the customer prior to demanding payment from the guarantor. The banker should send to the guarantor a formal written demand for the guarantor’s liability.

**Determination of Guarantee:**

A contract of a guarantee may come to an end in any one or more of the following cases:

1. **Payment by the Principal Debtor:**

When the Principal debtor pays the debt, the guarantor is discharged from all liability, because the debt is extinguished.

1. **Payment by the Guarantor:**

When the guarantor makes payment of the debt for which he has accepted the liability, the guarantee comes to an end. Generally it is the creditor who asks the guarantor to fulfill his obligation by making payment; but sometimes the guarantor himself serves notice to the creditor for the determination of the contract. The provisions for such a notice are generally mentioned in the guarantee, and it is stipulated that the guarantee shall continue until a stated period after the notice has clapsed.

1. **Misrepresentation by the Guarantor:**

A contract of guarantee, like any other contract, is liable to be avoided if induced by material misrepresentation of an existing fact, though made innocently. Therefore, a guarantee may be set aside if the guarantor was induced to enter into it by a misrepresentation of fact, though made innocently.

1. **Notice of the Guarantor’s Death:**

It was held that a guarantee does not cease to be a security unless and until the creditor receives the notice of the guarantor’s death.

If, indeed, the contracting parties desire that on the death of the guarantor a special notice shall be necessary to determine the guarantee, they can so provide in the guarantee itself; and such a provision will, of course, bind the estate.

It should be noted that the expression “bind the estate”, used by the learned judge, refers to the advances made during the currency of the notice given by the guarantor’s personal representatives.

1. **Insolvency of Guarantor:**

A guarantee is terminated when the guarantor is declared insolvent. The termination applies only to further advances to the principal debtors; but the guarantor’s liability to the advances already made to principal debtor remains valid. Upon learning about the guarantor’s insolvency, the banker should stop the account at once and demand payment from the principal debtor; and insolvency Act has authorized the bankers to prove against such guarantor’s estate even before default of the principal debtor.

1. **Change of Parties:**

Change of the parties means the change caused by death, insolvency, retirement or admittance of a new partner or partners. If the guarantee does not provide for any such contingency, the guarantee will be revoked and the Rule in Clayton’s Case will operate in the account.

1. **Release of Debt by the Creditor:**

When the creditor released the principal debtor from his liability, the guarantor is discharged.

It may be added that a discharge of the principal debtor after adjudication in bankruptcy does not affect he guarantor’s liability.