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Suretyship, Guaranty and Indemnity--Distinctions

E. H. Y.

West Virginia University College of Law

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SURETYSHIP, GUARANTY AND INDEMNITY—DISTINCTIONS.—

What is the distinction between a contract of suretyship, a contract of guaranty, and a contract of indemnity?

To say that the distinction between a contract of suretyship and one of guaranty is a shadowy one and that the words "surety" and "guarantor" are often used indiscriminately as synonymous terms is to state a well known fact. In a broad sense a contract of guaranty corresponds with that of suretyship, the distinction between them being merely technical, and a transaction which is called in some cases an absolute guaranty is denominated by other courts a contract of suretyship. A guaranty is like a suretyship in the sense that it is an engagement to answer for the debt, default or miscarriage of another and it is for this reason that the terms "surety" and "guarantor" or "guaranty" are often confounded and used interchangeably.¹ Yet there are points of difference between them which should be carefully noted. A surety is usually bound with his principal by the same instrument, executed at the same time and on the same consideration. He is an original promisor and debtor from the beginning, and is held ordinarily to know every default of his principal. Usually the surety will not be discharged, either by the mere indulgence of the creditor to the principal, or by want of notice of the default of the principal, no matter how much he may be injured thereby. On the other hand, the contract of the guarantor is his own separate undertaking, in which the principal does not join. It is usually entered into before or after that of the principal and is often founded on a separate consideration from that supporting the contract of the principal. The original contract of the principal is not the guarantor's contract, and the guarantor is not bound to take notice of its non-performance. The guarantor is often discharged by the mere indulgence of the creditor to the principal, and is usually not liable unless notified of the default of the principal.² One instance of the disagreement of the courts with respect to the characteristic features of these contracts which are relied on as distinguishing features is the emphatic differences of opinion as to the requirement of notice to the guarantor of the default of the principal. The court

¹ 28 C. J. 890, §5 and cases cited.

² 1 BRANDT, SURETYSHIP AND GUARANTY, 3rd Ed., §2.

in an Indiana case³ said: "There is considerable loose writing in the text books upon the subjects of guaranty and suretyship. Sometimes the two things are confounded throughout, and the terms used interchangeably, as signifying the same thing. This has introduced some confusion in the cases, so that there are *dicta*, and even decisions, to the effect that, to fix the liability of a guarantor, notice of default of the principal debtor is required, much as in the case of an indorser of strictly commercial paper."⁴ The doctrine of requirement of notice seems to have been applied mainly in cases of letters of credit and guaranty of commercial paper; and its soundness has been utterly denied even in that class of cases, in New York and Massachusetts.⁵

The importance of making the proper distinction between a surety and a guarantor lies chiefly in this, that a surety is in the first instance answerable for the debt for which he makes himself responsible, and his contracts are often specialties, while a guarantor is only liable when default is made by the party whose undertaking is guaranteed, and his agreement is one of simple contract. The principal and surety, being directly and equally bound, may be sued jointly in the same suit, while the guarantor, being bound by a separate contract and only collaterally liable, can not usually be joined in the same suit with the principal.⁶ The distinction is particularly difficult to make when the guaranty is absolute as distinguished from a conditional guaranty. An absolute guaranty is an unconditional undertaking on the part of the guarantor that the debtor will pay the debt or perform the obligation. A conditional guaranty imports the happening of some contingency other than the default of the principal debtor. An absolute guaranty of payment differs from a conditional guaranty in that in the first case the liability of the guarantor is fixed by the failure of the principal debtor to pay at maturity,

³ *McMillan et al. v. Bull's Head Bank*, 32 Ind. 11 (1869).

⁴ *Smith v. Bainbridge*, 6 Blackf. 12 (1841); *Douglass v. Reynolds*, 7 Pet. (U. S.) 113 (1833); *Virden v. Ellsworth*, 15 Ind. 144 (1860). But see *Reynolds v. Douglass*, 12 Pet. (U. S.) 497 (1838), for an important modification of the former ruling in the same case to the effect that "the guarantor of a promissory note, whose name does not appear on the note, is bound without notice, where the maker of the note was insolvent at its maturity, unless he can show he has sustained some prejudice by want of notice of a demand on the maker of the note and notice of non-payment."

⁵ *Oxford Bank v. Haynes*, 8 Pick. (Mass.) 423 (1829); *Douglass v. Howlan*, 24 Wend. (N. Y.) 35 (1840); *Smith v. Dann*, 6 Hill (N. Y.) 543 (1844).

⁶ *Supra*, n. 2.

while in the second the contract is in the nature of a guaranty of collection, no liability being incurred until after, by the use of due diligence, the guarantee has become unable to collect the debt from the principal debtor.⁷

A very catchy phrase was once written down by somebody which was made to read: "A surety undertakes to pay if the debtor *does not*. A guarantor undertakes to pay if the debtor *can not*." Stearns in his text on Suretyship⁸ comments on this phrase, saying that it has rhythm and euphony and by its literary excellence seems to have captivated legal writers and jurists from the very start, but that the phrase will not stand analysis; that both conditions "if the debtor does not" and "if the debtor can not" belong to and are descriptive of the guarantor, and neither one of the surety. The condition "if the debtor does not" if applied to the surety, could only mean the surety is *not* liable if the debtor *does* pay, which, of course, imposes no condition, and is meaningless as a legal expression. There are no conditions in the contract of the surety other than those which are in the principal's contract. The distinction between absolute and conditional guaranty must not be overlooked.

In construing contracts of suretyship, in an effort to determine whether they are contracts of suretyship, in the narrow sense, or contracts of guaranty, the courts have applied various tests. One test is, whether the contract fixes time of default on the part of the principal debtor; if it does not, it is held to be a contract of guaranty, and if it defines the time of default when the surety is to pay or see the debt paid it is one of suretyship.⁹ Some courts have held that the joint execution of a contract by the principal and another operates to exclude the idea of a guaranty and is in all cases a circumstance pointing toward suretyship.¹⁰ In some instances courts look to the consideration in order to determine the nature of the contract. If the considera-

⁷ 12 R. C. L. 1064, §13.

⁸ STEARNS ON SURETYSHIP, 3rd Ed., 6, n. 9. The phrase quoted is from *Kramph's Executrix v. Hatz' Executors*, 52 Pa. St. 525 (1866), is quoted with approval and was so held in *McIntosh-Huntington Co. v. Reed*, 89 Fed. 464 (1898), cited in 28 C. J. 891, n. 49a.

⁹ *Homewood People's Bank v. Hastings*, 263 Pa. St. 260, 106 Atl. 808 (1919); *Westinghouse Electric Co. v. Wilson*, 63 Pa. Super. 294 (1916).

¹⁰ *Saint v. Wheeler, etc. Mfg. Co.*, 95 Ala. 362, 10 So. 589 (1892); but see *Shore v. Lawrence*, 68 W. Va. 220, 69 S. E. 791 (1910), in which a contract so executed was held to be a guaranty.

tion moves to the one who guaranties the contract of the debtor, it is a guaranty and not a suretyship.

Statutory definitions of suretyship exist in many states. For example, one state defines suretyship to be "an accessory promise, by which a person binds himself, for another already bound, and agrees with the creditor to satisfy the obligation if the debtor does not."¹¹ Another state, by its code, defines the contract of suretyship to be a contract "whereby one obligates himself to pay the debt of another in consideration of credit or indulgence, or other benefit given to the principal, the principal remaining bound therefor. It differs from a guaranty in this, that the consideration of the latter is a benefit flowing to the guarantor."¹²

According to text writers and the courts generally contracts of indemnity are distinguishable from either contracts of suretyship or contracts of guaranty. Contracts of indemnity are distinguished from those of suretyship in that in indemnity contracts the engagement is to make good and save another from loss upon some obligation which he has incurred or is about to incur to a third person, and is not, as in suretyship, a promise to one to whom another is answerable.¹³ Although one of the meanings of the word "guaranty" is "indemnity" or "save harmless" and the word "guaranty" may be used to create an obligation to indemnify one against loss, there are important differences between a contract of guaranty and one of indemnity. A guaranty being a collateral undertaking presupposes some contract or transaction as principal thereto, while a contract of indemnity is original and independent, to which there is no collateral contract and with respect to which there is no remedy against the third party. Many courts have stated the distinction between contracts of indemnity and those of guaranty in precisely the same words as the distinction between contracts of indemnity and those of suretyship has been stated.¹⁴ It is submitted that a contract of indemnity might be treated as a contract of "double suretyship," on the theory that the fourth party brought into the transaction, that is, the party to whom the surety's promise of indemnity runs, is really a second surety. The

¹¹ LA. REV. CODE, Art. 3035.

¹² GA. CIV. CODE, §2966.

¹³ 31 Cyc. 420 and cases cited.

¹⁴ 28 C. J. 892 and cases cited.

necessity for making the distinction between contracts of indemnity and those of suretyship and guaranty arises most frequently in connection with a plea by the indemnitor of the Statute of Frauds. The general rule is that a contract of indemnity, not being a promise to answer for the debt, default or miscarriage of another, is not within the Statute of Frauds.¹⁵

There are apparently very few West Virginia cases directly in point, and the expressions in them, like those of other courts, are unenlightening. A Virginia case, decided before the separation, defined the obligation of a surety as follows: "The obligation of a surety is not conditional, but absolute. His undertaking to pay is not in the event of the inability or unwillingness of the principal, but at all events and under all circumstances, as much so as if he were himself the sole debtor."¹⁶ In what seems to be the earliest case in West Virginia in which the court was called upon to distinguish between a contract of suretyship and one of guaranty, it was held that "the contract of a guarantor is collateral and secondary; that of a surety is direct. The guarantor contracts to pay if, by the use of due diligence, the debt cannot be made out of the principal debtor, while the surety undertakes directly for the payment, and so is responsible at once if the principal debtor makes default."¹⁷ When analyzed this holding seems merely to be a different way of using the "catchy phrase" referred to above, namely, "that a surety is one who pays if the debtor does not, a guarantor one who pays if the debtor cannot." If this is true, it is submitted that the court is drawing a distinction, not between a surety and a guarantor, but between an absolute and a conditional guaranty. A later case¹⁸ cites the earlier case with approval and holds that the "contract of a guarantor is collateral and secondary and when he guarantees the payment of a bond secured by collateral mortgage referred to in the bond he is not liable upon his guaranty until resort has been had to the mortgage, or to the

¹⁵ *Thomas v. Cook*, 8 B. & C. (Eng.) 728 (1828); *Wildes v. Dudlow*, L. R. 19 Eq. (Eng.) 198 (1874); *Faulkner et al v. Thomas et al*, 48 W. Va. 148, 85 S. E. 915 (1900); *contra Green v. Creswell*, 10 A. & E. (Eng.) 453 (1839).

¹⁶ *Humphrey v. Hitt*, 6 Gratt. 509 (1850), cited in a Monographic Note on Suretyship in 2 Rand. (Va. Rep. Ann.) 330.

¹⁷ *Kearnes v. Montgomery*, 4 W. Va. 29 (1870).

¹⁸ *Middle States Loan, Etc. Co. v. Engle*, 45 W. Va. 588, 81 S. E. 921 (1898).

bond, for the collection of the moneys secured, unless the principal be insolvent, rendering further pursuit fruitless."

In what is apparently the latest case in point in West Virginia¹⁹ the alleged surety was named in an agreement of lease as a third party and signed the agreement, in which he agreed "for a consideration deemed valuable to him" that if the second party failed to pay the rental in accordance with the terms of the agreement he, the third party, would pay it. It was argued that the third party was a surety, evidently because he had joined in the contract with the principal, and according to text authority²⁰ a surety is one who joins in the contract of the principal and becomes an original party with the principal. But the court held that since the alleged surety did not join in those portions of the lease which imposed a primary obligation to pay the rent, his agreement was not a primary undertaking, but a promise to pay in case the principal should fail to do so; that it was, therefore, "a conditional and collateral agreement, defined in the law as a guaranty," and that the guarantor could not be joined with the principal as a defendant.

How to solve the problem of making the proper distinction in such cases is still a question. Perhaps the enactment of statutes similar to those of Louisiana and Georgia is a step in the right direction.

—E. H. Y.

¹⁹ *Shore v. Lawrence*, *supra*, n. 10.

²⁰ STEARNS ON SURETYSHIP, 2nd Ed., 5.

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