GUARANTORSHIP; ANALYSIS OF THE LAW AND PRACTICE IN UGANDA

BY

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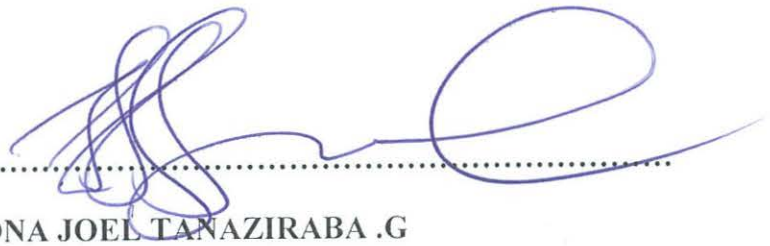
DECLARATION

I, *kakona Joel Tanaziraba G*, hereby declare that this research work is original and has never been presented in any other institution for academic award.



Signed.....

KAKONA JOEL TANAZIRABA .G

Date 14TH JULY 2010

Signed.....

MR MUHAMUD SEWAYA

SUPERVISOR

Date.....14/7/2010.....

DEDICATION

This research is dedicated to my mother, Mrs *Byawano Joy* for tireless and selfless efforts in guiding me to be what I am and for the great commitment to seeing me complete my education. Even death would not diminish her hope in me, thanks very much for believing in my academic accomplishment.

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First of all I would like to thank the Almighty God for the generous love, good health and wisdom during my studies. Special thanks to madam *Nabirye Jennifer* and her husband, my dear uncle *Maena Nimrod* for their endless love, care, guidance and inspiration during my studies, not forgetting my dear brothers, *Mugoya Derrick Eddy, Ojwang Emma, Junny, Herbert*, for their moral, emotional support, love care and encouragement remains a debt to me.

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But most esteemed appreciation goes to *Vision for Africa* especially *Mama Maria*, who have given hope to the unprivileged children of Uganda, May God keep blessing her Ministry.

ABSTRACT

Guarantorship is a green area of study in Uganda with very little information and familiarity among the academia. This has been caused by the insufficiency of the legal regime, unscrupulous desire by the creditors, to keep off the guarantors from precisely making informed decisions. The fact that guarantees are becoming popular with the expanding banking sector, therefore the research undertakes to discover solutions to the existing problems in the operation of the guarantorship. This research traverses the current legal regime on guarantees and emphasizes on the inadequacies and suggests an ideal situation. Guarantorship is an asset to the economic empowerment of the public.

TABLE OF STATUTES

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Moschi v Hep Air Services (1973) AC 331

Mutual Finance Ltd v John Wetton & Sons Ltd (1937) 2 KB 389, (1937) 2 All ER 657

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Ottoman Bank v K S Mawani & Others (1965) EA 464

Perry v National Provincial Bank of England (1910) 1 Ch 464

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CHAPTER ONE

GENERAL INTRODUCTION

1.1 INTRODUCTION

Guarantorship is not a very new word in legal sense (banking contract mainly). The law relating to guarantee in Uganda is based on common law of England. The legislation on guarantees is uncertain for we have no precise law on the subject of matter which calls for the engagement of legislators. The legal regime in Uganda serves to protect the bank(s) who the guarantee is made in favor of; unfortunately the guarantors often execute the guarantee without necessarily knowing the legal efficacy attached to it. Further debtors secure guarantees on friendship basis. common to find that principal debtor and guarantor are friends according to their varying degree. This topped with ignorance of the guarantors presents a serious problem.

To the banker, all is concerned with is recovery of the money let out to the debtor. Even the available law grants the bank protection against rights to the guarantor available at common law.

1.2 BACKGROUND TO THE STUDY

The development of guarantees started as the simplest method, whereby a trusted merchant or bank stood as a guarantor for others less well known to the lender. This method became widely used in international trade generally known as acceptance financing. Guaranty's evolvement was part of the development and evolvement of the banking sector.[1]

Banking began with the financing of individuals. As merchants expanded their business a need arose for credit. Even in a basically barter system farmers had to be paid promptly, storage was necessary prior to shipment and voyages often took several months. Thus was created the first financing of what we now call accounts receivable and inventories.[2]

This need for finances became even more critical as commerce became more specialized. merchants in grain, olive or cloth learned that they would compete more effectively and that

[1] *William Curram, Banking and Global System, Woodhead Faulkner Limited 8 market passage Cambridge CB2 3PF (1979), 28-29.*
[2] *Ibid.*

profits would be greater than specialization. They would buy and sell in greater volume, in some cases controlling the market price, they could ship more cheaply and they could become more expert in their special field. This lessened the dangers of all but natural disasters. Lending support to this development were the city states first and foremost, these Provided protection but of equal value to commerce they provided particularly in Italy the important ingredient of commercial law and a system of money-two bequests from an earlier empire. It then remained for the banks to supply the third elements- credit.[3]

At first credit was extended against the deposit of an article of greater value than the debt the article was returned when the debt was repaid. This soon proved impractical. A method of mortgaging was developed whereby the article that was security for the loan was not transferred to the creditor but remained with the debtor who continued to make use of it. Anything short of these two methods of lending against tangible security required another system. The simplest method was guaranty; where trusted merchant stood as a guarantor to the less known merchants to the lender.[4]

1.3 STATEMENT OF THE PROBLEM

Guarantees, just like other forms of securities for loans has been around and available to the public for a long time. Unfortunately the beneficiaries tend to exploit the guarantors. Common that a guarantor is not aware of the extent of liability carried with the guarantee; cannot imagine that they may be called upon by the banking institution to make good of their commitment to the bank. This confusion is created by the principal debtors who do not explain the obligations to the guarantors; but that is understandable in the sense that if the guarantor is told of every detail may turn down the request.

To greater dismay, the bankers have no duty to volunteer information to the guarantors or sureties; they can only answer to queries that are made by the guarantor. This further disadvantages the guarantors in terms of knowledge empowerment to act informant. The

[3] *Ibid.*
[4] *Ibid.*

combinations of factors as will be considered in the research are the main concerns for the little or no protection to the guarantors in Uganda.

1.4 SIGNIFICANCE OF THE STUDY

The study shall be aimed at focusing on how financial institution, law regulations and policies in Uganda can be implemented so as to improve on the operation of guarantees; providing adequate protection to guarantors while at the same time protecting the interest of the lenders-bankers.

It is also intended to explore the levels of awareness of the laws, regulations and policies governing guarantees. The findings will help provide in information for improvement consistent progress and achievement of aims and objectives of institutions and esteemed customers. Therefore; the study will be vital and timely during this period when the Government of the Republic of Uganda is working out means of fulfilling prosperity for all[5]. This study will become a handy tool especially to policy makers, legislators, researchers and guarantee beneficiaries as it seeks to add and or vary the current knowledge about guarantees in Uganda.

1.5 OBJECTIVES OF THE STUDY

The broad objective of this study is to find out whether existing legislation on guarantees accords sufficient protection to the parties in the transaction.

The specific objectives of the study are;-

(a) To analyze the development of the law relating to guarantees/ guarantorship.

(b) To examine the effects of the law on the general operation of guarantorship and liability borne by the guarantors.

(c) To explore how knowledgeable clients are on the laws policies and regulations governing guarantees and credit financial services.

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[5] *Prosperity for all is the National Resistance Movement programme initiated by President Yoweri Kaguta Museveni intending to eradicate poverty among Ugandans, popularised in the 2001 presidential campaigns.*

(d) To critique the way in which banks handle guarantors especially in ensuring repayment of their loans without caring about the rights of guarantors.

(e) To investigate the legal protection of interest of both banking institutions and targeted clients and guarantors, and

(f) To identify and suggest a more appropriate model of handling guarantorship in Uganda.

1.6 HYPOTHESIS

(a) The legal regime governing guarantorship in Uganda and their enforcement must be strengthened and revised especially the provisions relating to differential treatment of parties to the guarantee.

(b) Educating the guarantors on the legal liability to the contracts of guarantee is necessary to ease tension in their execution and implementation.

(c) Bank of Uganda as the custodian of banking needs to play a more vital role in sensitizing the public; without which guarantors' exploitation will continue.[6]

(d) It is argued that the law, policies and regulations regarding guarantorship in Uganda are insufficient in protecting the interest of guarantors.

1.7 SCOPE OF THE STUDY

The study covers period from 1960s when the banking sector started growing in Uganda. However a lot of greater interest will be drawn to 1980s when banks attracted attention from many clients' even rural dwellers. The geographical scope shall be mainly in Kampala where the greater concentration of banking business is, though rural areas are having micro finances situated there to tap the rural savings. The subject scope of this study is the sufficiency of the protection granted to guarantors/ sureties as a form of loan security or financial accommodation.

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[6] *Art 162, Constitution of Uganda & Section 4 of the Bank of Uganda Act Cap 51 Laws of Uganda.*

1.8 SYNPOSIS

Chapter one shall give the general introduction and background to the study, state the problem being investigated and its scope. The chapter shall also state the purpose of the study, hypotheses and review related literature to this study. It will also justify its undertaking; provide the theoretical framework of this study discuss the methodology adopted to obtain data for the study and state as significance.

Chapter two Shall discuss the nature of guarantees generally in light of the formal legal requirements. This chapter shall also distinguish guarantees from other contracts; obligations owed to an intending guarantor, and the rights of guarantors. Researcher shall also seek to establish how the financial institutions handle guarantees. The chapter shall also seek to establish what has been done by the institutions (banking) to promote easy operation of guarantees.

Chapter three The chapter will analyze legal regime affecting guarantees, the general guarantor's liability, conditions that may vitiate guarantees and further the chapter will consider how the guarantee contract can be determined. *Chapter four* shall consider the enforcement of guarantees and the problems associated with the enforcement and any consequences if any accruing from operation in Uganda and lastly *Chapter five* will draw conditions and recommendations to the findings of the study.

1.9.1 LITERATURE REVIEW

William Curram's[7] book discussed the historical development of guarantees. To him the guarantees started as the simplest method where a trusted merchant or bank stood as a guarantor for others less known to the lender. This method became widely used in International trade generally known as acceptance financing. Guaranty's evolvement was part of the development and evolvement of the banking sector.[8] This book will be important to the research in that will be relied on in tracing the development of the guarantees until present.

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[7] *William Curram above n1.*
[8] *Ibid.*

Geoffrey Lipscombe in his book[9] discusses guarantee as a legal undertaking by one person the guarantor to a lender to be responsible for the debt of another-borrower. Guarantees are solemn undertakings which most guarantors do not really understand: guarantees are not strictly security because the lender has to assess the credit worthiness of the guarantor and will usually require the guarantor to charge society in support of his or her guarantee.

David Cox's'[10] book looks at guarantees as collateral security. He states that guarantee is a collateral security involving three parties in which the third party, the guarantor agrees to be liable for the debts of a second party, the bank customer, if he does not pay the first party the bank. However *Cox* gives no treat to the problems faced by guarantors.

Hanson[11] discusses one of the important points to consider in choosing a guarantor, the financial suitability of the guarantor proposed by the principal debtor. The book observes that, "No matter how satisfied a banker may be as to the integrity of his customer and suitability of the proposition, he may wish to reinforce his position by taking security...in some cases the only available security is the guarantee by a third party. This is perfectly acceptable if the third party is of sufficient means but any guarantee law the disadvantages that in event of the customers default the bank has to look to the guarantor for payment if a necessary take proceedings against him people who give guarantees seldom contemplate the possibility that they may be called upon to pay."

Med Kyamanywa's[12] book discusses guarantee as an engagement to be collaterally answerable for the debt, default or miscarriage of another person. There can be no contract of guarantee unless there is a prior contract in existence. The principal debtor is liable on the first contract and the guarantor is only liable on the second contract and the creditor bank is a party to both. A guarantee must be evidenced in writing. A guarantee must be signed by the guarantor and must be supported by a consideration unless under seal. Bank guarantees usually express it as "affording banking accommodation or continuing the account or giving time" for repayment.

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[9] *Geoffrey Lipscombe, Banking; The Business; Elementary Lending and Security for Lending, Pittman publisher, 1st ed (1990) 156.*
[10] *David Cox, Success in Elements of Banking, unit 21 (1990) 322.*
[11] *DG Hanson,Service Banking; The All Purpose Bank, Bankers books ltd published, 3rd ed (1987) 76-77.*
[12] *Med Kyamanywa, The East African Diploma in Banking, Lending Work Book, Distance Learning; UIB (2005) 124.*

Kyamanywa makes a general writing on the subject without necessarily Uganda's position on guarantees.

Mark Hapgoods[13] book discusses how guarantees arise. It is argued that a guarantee could arise even where there is no personal undertaking to be liable but a charge or other security has been given over a surety's property for another's debt or performance of the obligation.

Grace Patrick Tumwine's[14] book also discusses some instances in which guarantees may be illegal or ultra vires, which are termed as "special cases" in guarantees. Just like Kyamanywa, Tumwine makes a general writing on the subject without necessarily Uganda's position on guarantees.

David Cox[15] further discussed about valuation of guarantees. Most guarantees are easy to value in that the money amount is usually stated on the guarantee form. How much a bank would actually receive from the guarantee if security was realized is a different matter! The valuation to be made by the manager is an assessment of the status of the proposed guarantor who must be considered both able and willing to pay if called upon.

F E Perry[16] in his book noted that if the manager has doubts he can all upon the guarantor to deposit further security in support of guarantee. Once the guarantor has been named the bank management confirm by seeing him or writing to him, that he is willing to undertake the responsibility. The guarantor's bank must be written to for a report on his standing status enquiry.

He [17] further observed that if reply is satisfactory, the guarantor or will be invited to call at the branch or another branch more convenient to him to sign the guarantee. His signature must be witnessed and has to come to the bank so that bank can be certain in that signature is genuine and not forged.

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[13] *Mark Hapgood QC, Paget's Law of Banking, Butterworths, 12th edn, (2003) 702.*
[14] *Grace Patrick Tumwine, Essays in African Banking Law and Practice, Uganda Law Watch (1998) 421.*
[15] *David Cox above n10, 323.*
[16] *FE Perry; the Elements of Banking, Methuen& Co ltd with Institute of bankers, 1st ed (1975) 317.*
[17] *Ibid.*

David Cox[18] further discussed how banks obtain a legal title in a guarantee. The mechanics of taking a legal guarantee are simple when a person offers himself as a guarantor of an account the manager usually explains to him that in the event of customers default he will be liable to pay to the amount of the guarantee. The guarantor then signs the bank's form and if he does not maintain an account being guaranteed, the bank takes steps to check his financial standing by making a status enquiry on his bank and branch if the reply is satisfactory the advance is granted to the customer.

He observed further that the major problem of guarantees is that however hard the bank tried to explain the potential liability, the guarantor never expects to be called upon to pay. There can be serious ill feeling between the guarantor and the bank if this should happen; it may be difficult to persuade him to pay without taking court action some thing that a bank would only undertake as last resort.[19]

The solvency of the guarantor; unless supported by collateral security a personal guarantee offers a less stable form of cover. The position of a surety may change without knowledge. It is extremely difficult to keep in touch with financial position of the guarantor from time to time[20]. Thus it is been emphasized by *Mukubwa* that the banker must ensure that an effective agreement or enforceable contract is executed to cover all contingencies as would give the banker a legal remedy against the guarantor.[21]

Med Kyamanywa observed that a banker is entitled to assume that guarantor has made himself acquainted with the financial position of the customer he intends to guarantee and you are not bound voluntarily to make any disclosure regarding the customers. However if any information is given then the disclosure must be a full and fair on.[22]

However when the guarantor asks questions bank must make straight forward replies which are not capable of being misunderstood. As for right to disclosure, having regard to *the rule of*

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[18] *David Cox, above n15*
[19] *Ibid.*
[20] *med Kyamanywa above n 12, 125.*
[21] *Grace Mukubwa above n 14, 420.*
[22] *Med Kyamanywa above n12, 126.*

secrecy. if asked for information by a proposed guarantor, you should arrange a unit meeting of all parties to discuss the matter or obtain authority in writing of the customer to be guarantee[23].

The bank does not suggest name of a prospective guarantor to the borrower for subsequently the guarantor might contend that thereby the bank had made the principal debtor its agent any misrepresentations by him might suffice to avoid the guarantee. In the same guide the form of guarantee is not handed to a principal debtor to enable him to obtain signature of the guarantor. for if he deceives the guarantor as to the nature of the guarantee, the guarantor could possibly escape liability so long as he has not been negligent on the plea of "*non est factum*" *(not my deed)*....mistake as to nature of contract[24].

The guarantor is entitled to inform himself of any fact which is important in helping him to make up his mind whether to sign the guarantee or not. However the banker (manager) does not have to volunteer information. His duty is only to answer truthfully any relevant questions in guarantor may ask; any more might breach the duty of secrecy to his customer. [25] After the guarantee has been signed the surety/ guarantor is entitled to have particulars of his liability at any time but not to have details of or to inspect. The debtors account.[26]

when the guarantor pays off the whole of the debt, he is entitled to claim from bank any security which has been deposited against the debt not only by the principal debtor but also any other person or body. If the bank has sued the principal debtor, the guarantor would similarly be entitled to the benefit of any set of or counterclaim or principal debtor may have against the bank[27]. To avoid this, the usual bank form of guarantee has an indemnity clause and in fact should be called an indemnity not a guarantee.

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[23] *Ibid.*
[24] *FE Perry; above n16,318.*
[25] *Hamilton v Watson (1845)12 Cl & Fin. 109.*
[26] *FE Perry; above n16, 318.*
[27] *Ibid.*

1.10 RESEARCH METHODOLOGY

The research is based on both qualitative and quantitative. This is intended to enable the researcher gather information on the subject. The research undertook a defined survey on guarantees executed and/or execution by financial institutions especially in Kampala and neighboring districts with a great economic influence in Uganda.

The researcher carried out a detailed library research for literature related guarantees in general and then critically analyzed it to find out how much has been written on the protection of guarantors. Libraries like those of Kampala International University, Makerere University, Institute of Bankers' Library and World Bank Library were of vital importance throughout the period of study. At the libraries a consideration to Law Journals, statutory and case law were of kin interest to the researcher during this time of research. Data was gathered through use of questionnaires and open ended questions were preferred to allow gather enough information.

1.11 CONCLUSION

After a thorough consideration of the information available about guarantees in Uganda, it is sad that much emphasis is given to the creditors, who are mostly banks, no thing is written about the challenges or problems faced by the guarantors, thus the most esteemed wish to deliberate on the subject in the research. It is desirable that research is undertaken to fix such legal insufficiency.

CHAPTER TWO

THE GENERAL NATURE OF GUARANTEES

2.1 INTRODUCTION

This chapter looks at the general nature of guarantees considering at the same time the legal requirements necessary to establish the guarantee. Also the chapter examines the rights available to guarantors, their nature and how applicable they are. In the same spirit an attempt is made to distinguish guarantees from other contracts.

2.2 NATURE OF GUARANTEES

A guarantee is a promise to be liable for the debt or failure to perform some other legal obligation of another. A guarantee obligation is secondary and accessory to the obligation the performance of which is guaranteed. the guarantor undertakes that the principal debtor will perform his (the principal debtor's) obligation to the creditor and that he (guarantor) will be liable to the creditor if the principal debtor does not perform.[28]

In *Moschi v Lep Air Services*[29]court held that since the creditor's acceptance of the debtor's wrongful repudiation of the contract was a right given to the creditors by the law of Contract. the exercise of that right did not discharge the guarantor from liability under the guarantee nor was it a material variation of the contract which extinguished the guarantor's liability.

Further the court noted that when creditors accepted the debtor's fundamental breach of the terms of the contract. including those guaranteed as repudiation of the contract. they were entitled to sue the guarantor in damages for the total sum guaranteed except in so far as already settled by payment made by the co. and the measure of damages was that net sum.

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[28] *Hapgood , Pagets' Law of Banking , Butterworth Lexi Nexis, 12th edn, (2002) 702.*
[29] *(1973) AC 331.*

2.3 FORMAL LEGAL REQUIREMENTS

Like in the general contract law, guarantees have particular legal requirements which must be fulfilled so as to bind the guarantor.

2.3.1 Writing For a guarantee to be binding it is required that it should be in writing. *Section 3*[30] provides that no action shall be brought where by to charge the defendant upon any special promise to answer for the debt default or miscarriage of another person unless the agreement upon which such action shall be brought or some memorandum or note there of shall be in writing and signed by the party to be charged there with or some other person there un to by him lawfully authorized.

2.3.2 Consideration

Like all other contracts[31], a guarantee must be supported with good consideration but failure to record the consideration in writing will not of itself make the guarantee unenforceable.[32] However Perry suggests that the consideration must be real.[33] Where the consideration is expressed in terms that are ambiguous as to whether it is past future, extrinsic evidence[34] is admissible to show that it is good consideration.

To determine whether the consideration given by the creditor is actual performance of an act stipulated in the guarantee or his executory promise to do that act will depend on the construction of the document; in the former case the guarantee will not become binding on the guarantor unless and until the act is performed, where as in the latter it will be immediately binding.[35]

However the practice is that banks make forms of guarantee containing a statement of the consideration, thus very difficult to avoid a guarantee on the basis of no consideration.[36]

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[30] *Contract Act Cap73 Laws of Uganda. See Section 4 of statute of Frauds 1677 of England.*
[31] *Bakibinga, Contract Law in Uganda, Fountain Publishers, 1st edn, (2001) 4.*
[32] *S 3 Mercantile Law Amendment Act of England.*
[33] *F.E Perry; Law and Practice, Relating to Banking; Methuen, Co Ltd, 4th edition, 1983 at pg 275.*
[34] *Wigmore on Evidence.*
[35] *Hapgood above n28, 704.*
[36] *J Milnes Holden, The Law and Practice of Banking, Securities for Banker's Advance, Vol 2 , 8th ed (1992) 202, Para 18-4.*

In *Vallabbhai P Patel v Central African Commercial Agency*[37]the respondent had sued the appellant on two promissory notes of which the appellant was guarantor. The appellant before filing a defense applied to the court to have the plaint rejected under O.vii, r.11, of the Indian Code of civil procedure, on the ground that it disclosed no cause of action, in that it failed to plead the consideration for the guarantee. The magistrate accepted this submission and rejected the plait. The respondent's appeal to the high Court was allowed on the ground that, whether or not it was necessary to plead consideration, the plaint to which the promissory notes themselves were annexed alleged facts showing consideration. On further appeal the appellant sought to have the judgment of the magistrate restored.

Court held that in an action against the guarantor of a promissory note consideration should be pleaded or shown in the plaint. That the plaint with the attached promissory notes raised a presumption of consideration, namely a request by the guarantor appellant, sufficient to disclose a cause of action against him.

Where a guarantee is executed just before the overdraft is granted, the accommodation is the consideration (the consideration moves towards the principal debtor) and this is sufficient support if the benefit is sought for the guarantor, this is presumably the satisfaction of securing the principal debtor accommodated.[38]
When the overdraft has already been granted and then guarantee is sought some change in amount or availability in terms of time should be indicated, otherwise the contract of guarantee may fail for lack of consideration.[39]

Therefore although the consideration need not be stated, it invariably is, a usual form of words being, "in consideration of the bank opening and/ or containing an account with the principal debtor" The continuation of the accommodation that is the forbearance of the bank in not terminating the arrangement and calling for repayment is then sufficient consideration.[40]

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[37] *(1959) EA 903.*
[38] *F.E Perry; ibid n33, 275.*
[39] *Ibid.*
[40] *Ibid.*

However, to cover future advances both on a current account and by other methods available to a bank customer, it is usual to add some form of words as "... or otherwise giving credit accommodation or granting time to the principal debtor, whether alone or jointly with another or others.[41] There after the bank should be safe on this ground unless the principal debtor is allowed to open other accounts and pays credit into them which should reduce or terminate the liability of the guarantor but do not do so because they are held separately.[42]

Thus in *National Bank of Nigeria Ltd v Oba M.S Awolesi*[43] a guarantor signed a form of guarantee in which the form of words was; "in consideration of the bank continuing the existing account with the principal debtor for as long as granting time to him." The guarantor guaranteed on demand in writing the due payment of all advances, liabilities, whether made before or after the date hereof to or for the principal" Subsequently the principal debtor opened a number 2 account. These credit balances were all drawn out again before the bank finally called upon the guarantor and it was held by the *Judicial Committee of the Privy Council* that the words "*continuing the existing account*" suggested that the parties to the contract of guarantee did not contemplate that a second account should be opened, but to the contrary meant that it was expected that the original account existing as at the date of the guarantee should be continued unbroken, so that all entries should pass through it. The opening of the second account was an unauthorized departure from the terms of the contract of guarantee, for this permitted the position of the guarantor to be prejudiced in that it was possible for the principal debtor to make payments in without pro tanto benefiting the guarantor.

It is easy enough to avoid this difficulty by requiring the guarantor to assume liability for any debt on the existing account or on any other account which may be subsequently opened or for any liability other wise contracted, such as a discounts bills, promissory notes, negotiations extra[44]

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[41] *Ibid.*
[42] *Ibid.*
[43] *(1964)1 WLR 1131; (1965)2 Lloyds Rep389.*
[44] *F.E Perry, ibid n33, pg276.*

2.3.3 Agreement

As in the case of any other contract, a valid guarantee requires a sufficient agreement .this process is reached by offer and acceptance. The agreement should be capable of legal enforcement and equally important is the need to establish the legal debt owed by the principal debtor. The original debt is not discharged as between the parties and the debtor is not released from indebtedness by the existence of the guarantee.[45]

The guarantee is a collateral in fact in that it merely strengthens the personal obligation of the debtor and does not create any interest in the loan so granted in favor of guarantors who become liable as such notwithstanding that there was no consideration for their guarantee.[46]

Thus in *Grindlays Bank (U) Ltd v James Ocola & ors*[47] the High Court of Uganda observed that under the law of Guarantees, a guarantor for a loan need not have a personal proprietary interest in the loan granted on his guarantee.

2.3.4 Disclosure of information

A contract of surety ship is not in the general sense a contract uberrimae fidei (of the utmost good faith) wherein mere non disclosure without fraud of a material fact will automatically make the contract voidable.[48] In *Hamilton v Watson*[49] it was observed that if the bank is not asked for information, need not volunteer to the surety information as to how the debtors account has been conducted, whether the debtor is already overdrawn or whether he has been punctual and honorable in his dealings.

The practice is that a bank is entitled to assume that the guarantor has made himself acquainted with debtor's reputation and financial position. However banks are required to exercise care to avoid any possible charge of misrepresentation. Where any information is to be given, it must be full and fair and if the guarantor asks questions banks have to make unequivocal replies.[50]

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[45] *Grace Mukubwa, Essays in African Banking Law, Uganda Law Watch (1998) 419.*
[46] *Ibid*
[47] *Civil suit no 1071/1978.*
[48] *T G Reeday, Law Relating to Banking, 5th (1985) 311.*
[49] *(1845) 12 Cl & Fin 109.*
[50] *Reeday, ibid n48, 311.*

2.4 GUARANTEES DISTINGUISHED FROM OTHER CONTRACTS

2.4.1 Guarantee and indemnity

Contracts of guarantee and contracts of indemnity may perform similar commercial functions in providing compensation to the creditors for the failure of a third party to perform his obligations. However there is a conceptual distinction between a contract of guarantee and a contract of indemnity in that under a contract of indemnity the indemnifier undertakes an independent obligation which does not depend up on the existence of any other obligation which does not depend upon the existence of any other obligor.[51]

In *Western Credit Ltd v Albery*[52]Court of Appeal held the claim failed because the contract signed by the surety was a guarantee of the due performance by the hirer of the purchase agreement not a contract of indemnity and as the hirer had duly performed his obligations, the purchase company. Couldn't recover under the guarantee; more over there was no 'loss' suffered by the hire purchase company, for the company had merely failed to obtain the profit that they would have derived if the hirer had not elected to terminate the contract this decision was based on the fact that hire purchase company intended to pursue the surety for loss of profit incurred by the hirer electing to terminate the hiring before the end of the hiring period.

A contract of indemnity is a contract by one party to keep the other harmless against loss but a contact of guarantee is a contract to answer for the debt default or miscarriage of another who is to be primarily liable to the promise per *Holroyd Pearce LJ in Yeoman Credit Ltd v Latter*.[53]

The contracts of indemnity have the following characteristics;-

1) There is need to be only two parties interested; the person giving the indemnity and the person to whom it is given.
2) The person giving the indemnity is primarily liable rather than secondarily liable the indemnifier is liable to pay ultimately the amount suffered by the creditor.
3) The person giving the indemnity usually has some interest in the transaction apart from his indemnity.[54]

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[51] *Halsbury Laws of England, 4th edition Reissue Vol 20 Para 109.*
[52] *(1964)2 ALL ER 938.*
[53] *(1961) 2 ALL ER 294 at 296.*

Whether a contract is one of guarantee or indemnity is a question of construction the fact that the parties have their a agreement as an indemnity or as a guarantee may provide some guide especially if the expression is used in the heading or repeated a number of times in the body of the agreement.[55] In *Yeoman v Latter*[56] consideration was given to the style and adopted in wring the agreement and also the terms there in to find that the agreement was one of indemnity.

2.4.2 Contract of insurance

The insurer under a contact of insurance agrees in consideration of the payment to him of a premium to pay a specified sum to the insured up on the happening of a specified event per *Channel J in Prudential Insurance Co v IRC*[57]; where that event is a default by the debtor or obligor, the contract bears a striking resemblance to a guarantee.

However, there are distinctions between the nature of the two types of contracts and between the obligations which they create. Insurer like under indemnity under takes a principal rather a secondary obligation to the creditor. An insurer's liability is not a third person's liability whereas a contract can not be a guarantee unless it is ancillary to be primarily obligation of another person to which the guarantee liability is secondary.[58]

2.5 TYPES OF GUARANTEES

a) Specific guarantees: These covers one isolated debt only, and can typically be taken as security for a personal loan. Banks rarely take this form of guarantee because of its inflexibility for it will not cover any other borrowing or liabilities that the customer owes to the bank.[59]

Further, if the exact terms of the guarantee are not met, then the guarantee will be ineffective example a guarantee of £500 has been taken as security for a loan of £500 agreed by the bank to

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[54] *R.B Vermeesch and KE Lindgren, Business Law of Austria, Butterworth's, 7th ed (1992) 950.*
[55] *Hapgood, Pagets' Law of Banking, ibid n 28*
[56] *Ibid n 53.*
[57] *(1904) 2 KB 658 at 663.*
[58] *Hapgood, Pagets' Law of Banking, ibid n54.*
[59] *EP Doyle EP & P Gerrard, Personal Course for Bankers; Practice of Banking 1, Securities for Advances vol 2 revised edition, Northwick Publishers (1987) lesson 16-3.*

enable the customer to buy a car. As a result of a discount that he negotiates, he only needs to borrow £400. In these circumstances, the specific guarantee would be ineffective, even though the amount advanced is less than amount of the guarantee.[60]

b) Continuing and limited in amount guarantees: In practice, this is the most common type of guarantee, for it secures any bank account or liability that the principal debtor owes the bank. It will be drawn up to cover all monies now or hereafter owing by the principal debtor either alone or jointly in respect of any account or liability subject to a limitation of say £5,000. Such a guarantee liability covers any indebtedness or liability (such as a joint or partnership account) and will even pick up any liability he owes to the bank as surely such as where he had guaranteed the account of another person or company.[61]

c) Continuing and unlimited in amount: This type of guarantee will include a clause similar to that of continuing and limited guarantee but that part of the all monies clause which states ".....subject to a limitation of.." Will have a horizontal line drawn through it and the guarantor's signatures) placed by the deletion as confirmation. This, in effect, means that bank can recover any amount from the guarantors) which the debtor owes to the bank.[62]

In Surgipharm Ltd v Awuondo & Another,[63] the plaintiff brought an application seeking summary judgment or alternatively striking out of the defense filed by the defendant of the judgment on the ground that the defenses were scandalous, frivolous and vexatious. The plaintiff's claim was for goods supplied on credit to a third party and guaranteed by the defendant. The application turned largely on the effect of a guarantee. There was a limit of Ksh 75000 in the initial application although from the subsequent dealings between the parties, higher amounts than the Ksh75000 were contemplated as appeared from the accounts. The guarantee itself was unlimited in amount and of a continuing nature. There was no stipulation in the

[60] *Ibid.*
[61] *Ibid.*
[62] *Ibid.*
[63] *(2003)1 E.A 344.*

guarantee for notice of default or demand upon default by the guarantor. A second unsigned guarantee was also exhibited whose purpose was intended to cover further forbearance including suit or intended winding up.

The defendants were challenging the application on the grounds that there was a limitation of credit in the application facility, that a demand letter was not issued or sent to them, and that the second unsigned guarantee discharged the previous guarantee. Court held that if a guarantee is unlimited, the limitation of credit in the application facility is irrelevant to the guarantee. The limitation of credit of the facility as per the application was wiped away by the terms of the unlimited guarantee. It was not necessary to send out a demand letter since the guarantee was not a demand guarantee and the debtor was immediately liable to the full extent of his obligation with out being entitled to require notice of default. The second unsigned guarantee did not in law discharge the previous admitted and signed guarantee because it was extrinsic to it and was dealing with a different situation. It did not revoke or alter the previous guarantee in any way.

d) Demand guarantees and performance bonds

Art 2(a) of the ICC's Uniform Rules for Demand Guarantees[64] defines a demand guarantee as any guarantee bond or other payment undertaking, however named or described by a bank, insurance company or other body or person given in writing for the payment of money on presentation in conformity with the terms of the undertaking of a written demand for payment and such other documents for example a certificate by an architect or engineer, a judgment or arbitral award) as may be specified in the guarantee.

There is always a principal, guarantor and a beneficiary, where the beneficiary and the principal (debtor) are resident in different jurisdictions, the guarantor will usually be a bank in beneficiary's country and there is an interposition between the principal and guarantor a bank in the principal's country.[65]

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[64] *International Chamber of Commerce, Publication 458, published in October 1992, quoted from Paget's Law of Banking 12th ed at 729.*
[65] *Ibid.*

The bank is an instructing party and relations between the guarantor and instructing party are usually governed by a counter guarantee under which the instructing party gives an undertaking to the guarantor in the same terms as the guarantor's undertaking to the beneficiary.[66]

Performance bonds are a form of demand guarantee: they tend to be used where the underlying obligation is not the payment of money but the performance of other obligation such as those arising under a building contract.[67]

2.6 OBLIGATIONS TO THE INTENDING GUARANTOR

A contract of guarantee is not a contract *uberrimae fidei* (of utmost good faith) but there are parallels between it and a contract of life assurance. The difference is that neither the borrowing customer nor the bank is under any duty to disclose material facts to the prospective guarantor which might affect his decision whether or not to enter into the security.[68]

The duty of secrecy to the customers has meant that bank can not discuss the affairs concerning the customers account without prior consent. The practice is that where a guarantor inquires about certain facts, the banker organizes an interview with the intending guarantor and the customer; the customer has to indicate non objection to his or her affairs being discussed openly.[69]

The bank has no responsibility to give or volunteer any information concerning the customers account, either a sit stands at the present, or in the past. However the guarantor must not be misled, for if he is then the guarantee will be voidable at his option, and the bank could find itself unsecured if it called upon him to pay.[70]

When the bank obtains authority from the client/ customer to disclose, it must answer any question accurately, and if, in any discussions or correspondence, it becomes apparent that intending guarantor is under a misapprehension, then he/she must be corrected. If the bank does

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[66] *Art 2 (c) (URDG), n62.*
[67] *Ibid.*
[68] *J.E Kelly, Practice of banking 1, Pitman Publisher, 2nd edition (1987), p424.*
[69] *Ibid.*
[70] *Ibid*

not have its customer's authority to disclose, and it becomes apparent that the guarantor might be misled, then naturally before bank takes matters further it will approach its customer so that there is no breach of secrecy.[71]

In *Cooper v National Provincial Bank ltd*[72] the aspect of guarantee security was discussed: Mr Cooper gave two guarantees to the bank, but claimed later that he was not liable on those documents to him, when the guarantees were signed, that the customer's husband was an undischarged bankrupt and was signing as an agent on the customers account. Cooper also sought to avoid liability by saying that the bank's accounts has been operated unsatisfactorily in the past, as cheques had been drawn when there were no covering monies and these had subsequently been stopped by the drawer. *The court* did not accept these defenses and held that there was no obligation on the part of the bank to disclose information about the customer's account and the guarantees were good security.

There is not even any obligation to explain the maximum liability under the guarantee or it terms and effects if the prospective guarantor is a stranger to the bank. In *O'Hara v Allied Irish Bank ltd & another,*[73] *Harman J* rejected an application for leave to amend a draft defense to plead that the bank owed a duty of care since to explain the guarantee to the prospective guarantor on the grounds that no such duty could exist if the latter was not a customer of the bank. Although where he or she is customer the position may be different. *Lloyds Bank v Bundy*[74] in this case the guarantor an elderly farmer had been a customer of the bank for many years, his son formed a company which banked at the same bank branch, the guarantor went to discuss giving a guarantee to secure the company over draft, the guarantor relied solely on the advice of the bank manager to advice him about the over draft and said he always trusted the bank manager and simply sat back and did as was told. Court held that the bank owed a duty to ensure that the guarantor formed an independent and informed judgment. Since the bank had not done so the guarantee and legal charge were set aside for undue influence.

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[71] *Ibid.*
[72] *(1946) KB 1.*
[73] *(1985) BCLC 52.*
[74] *(1975) QB 326.*

It is important to note that a stranger guarantor would only be able to escape liability if material factors had been misrepresented to him by the bank either in the course of negotiations directly or possibly by the bank acquiescing silently to something said or written which clearly showed that the guarantor was under a misunderstanding. The misrepresentation might be innocent or fraudulent.

Mackenzie v Royal Bank of Canada[75] concerned an appeal from the decision of the *Privy Council*. Mrs Mackenzie succeeded in avoiding liability on a guarantee given to the bank because when she had executed the guarantee document at the bank it had in advertently been misrepresented that the transaction was away in which she would obtain the return of certain shares which she had lodged as security. *Lord Atkin* commented "A contract of guarantee like any other contract is liable to be avoided if induced by material misrepresentation of an existing fact even if made innocently."

A guarantee may also be rendered voidable by undue influence or duress. Undue influence exists where the party taking an obligation is unable to exercise his or her own free will. This may arise because of the relationship in which he stands with the other parties particularly the principal debtor.[76]

Undue influence is presumed to exist where there is a close association such as that between a patient and his doctor or between a priest and a member of his church. It can be particularly relevant where a wife is asked to guarantee a husband's account or that of a business in which he is involved, although here much will depend upon whether the wife is a business woman herself.

It would be risky for the bank to give the security document to the customer for him or her to arrange for it to be executed by a guarantor with who he or she stood in a judiciary relationship. A bank should always therefore deal directly with the party giving the guarantee or third party charge or that party's own solicitor.[77]

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[75] *(1934) AC 468.*
[76] *J.E Kelly, ibid n68 at 426.*
[77] *Ibid*

To ensure that guarantor can not later avoid liability if he or she is called upon to pays a bank will insist upon intending guarantor taking independent advice from his or her own solicitor, and usually an endorsement will be made upon the guarantee document signed by the solicitor, to the effect that he has explained the meaning of document, and implications of the liability to the guarantor, who has understood.[78]

It should be observed that the choice as to which solicitor to use lies entirely with the intending guarantor, and while banks frequently have local firms of solicitors who act for them, if the intending guarantor asks for solicitor to be chosen, dependant upon the circumstances, it might not be wise to direct them to a firm which regularly acts for the bank. If the intending guarantor has his or her own solicitor then they are the ones which bank would expect to use.[79]

In addition, where there is active relationship between the borrower and guarantor it is possible that in certain circumstances/ instances a special relationship could exist also or alternatively, between the prospective guarantor and the banker. This can arise where the intending guarantor is also a customer of the bank and relies entirely or mainly on the bank for advice in financial matters. In such situations it is advisable to have independent advice.

In *Lloyds Bank v Bundy*[80] court noted that there was relationship of trust and confidence between the guarantor and his bank manager and noted that while it was not wholly material to their decisions, the fact that the father was in account as customer in his own right was not irrelevant to their decision.

It was held that there had been conflict of interest on the part of bank and that in light of the overall circumstances there had been undue influence, thus rendering the securities voidable at the surety's option.

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[78] *Ibid*
[79] *Ibid*
[80] *(1975) QB 326.*

2.7 NATURE OF THE GUARANTORS RIGHTS

The rights of the guarantor in general are creatures of equity. Equity protects the guarantor by providing him in certain circumstances with a defense in whole or part to the guarantee. Equity confers upon the guarantor certain rights and imposes up on the creditor certain duties. However, it does not provide the guarantor with an independent cause of action against the creditor for damage for infringement of the rights or breach of the duties thereby conferred. Moreover, the existence of these equitable rights and duties is inconsistent with the existence between the creditor and guarantor of a general duty of care actionable in the cost of negligence.[81]

Nevertheless these equitable principles only supplement and do not replace the contractual rights which the guarantor would in any event have at law. By virtue of having assumed liability under the guarantee, the creditor has to respect the equitable rights conferred to the guarantor otherwise the surety may be discharged.[82]

In *Anson v Anson*[83] *Pearson J* commented about the contractual nature of the rights of the guarantors as follows. "The intention of the parties normally is that the principal debtor will remain the principal debtor; it is his or her debt and his or her obligation and he or she is expected to pay it. If the surety is called to upon to pay and does pay, that for the time being defeats the intention of the parties that the principal debtor shall and remain the principal debtor. In order to put that position right, and to restore it to the position intended by the two of them in their original contractual intention, it is necessary that the right of reimbursement should be read in the contract. The essence of the matter is that the principal debt is the primary obligation of the principal debtor, while the liability of the surety is only secondary liability, and it is the intention as between the surety and the principal debtor that the position of should be preserved. That is the explanation on the contractual lines of the implied term which confers the right of reimbursement."

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[81] *Harlsburys, above n51, Para305, 194-195.*
[82] *Geraldine Andrews & Richard Millet, Law of Guarantees, London Sweet & Maxwell, 3rd ed (2000) 351.*
[83] *(1953) 1 QB 636 at 641-642.*

2.8 RIGHTS OF A GUARANTOR

A guarantor enjoys many rights if he does not expressly waive them. These rights will be considered under three headings;-

(1) Those rights against the creditor.

(2) Those rights against the principle debtor. and

(3). those rights against co-sureties. if any.

However the common practice is that the bank forms of guarantee strip a guarantor of virtually all those rights which the law would otherwise confer upon him.[84]

2.8.1 Guarantor's rights as against the creditor

A guarantor is entitled at anytime during the currency of the guarantee to call upon the creditor to inform him/ her of the amount for which he is liable under the terms of his guarantee. A banker who is asked to supply this information has to exercise his care because the relationship between himself and the customer is confidential in nature.

In *Tournier v National Provincial Bank Ltd*[85] court observed an implied term in contract between the banker and his customer that the banker will not divulge to third persons without consent of the customer information about the customer's account except under the allowed circumstances like the compulsion by the law.

An act of the bank supplying the guarantors with the customer's account would be a breach of the duty of confidence and information is limited to customer's present liability.

2.8.1.2 The right to call upon the debtor to pay the amount

The guarantor has a right to have the debt paid by the principle debtor. Before the surety has been called upon to perform the guaranteed obligation but after that obligation has accrued. it is said that the surety has the right to compel the creditor him or herself to press the principal for the performance of the obligation.[86] In the past. a demand by the creditor was precedent to the

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[84] *J Milnes Holden above n36. 205.*

[85] *(1924) 1 KB 461.*

[86] *Harlsburys , above n51, Para 221.*

guarantor's liability; the guarantor would have no right against the principal debtor before a demand was made.[87]

In *Bradford v Gammon*[88] it was observed that an ordinary covenant contained in the agreement to indemnify the estate of the deceased partner did not entitle the plaintiff to insist upon the immediate payment of debts for which no demand had been made. That the obligation to make good the indemnity by payment was the right to enforce covenant arose when the demand payment was made and not before.

However in *Thomas v Nottingham Incorporated Football Club Ltd*,[89] *Goff J* held that after the guarantor had given notice to the creditor of the determination of the guarantee, he was entitled to call up on the principal debtor to pay, even though the guarantor was only liable on demand and no demand had been made. He further said that it would be strange if the guarantor couldn't seek to remove the cloud until it had started to rain.

2.8.1.3 Right to set off

Where the guarantor is sued by the creditor for payment of the debt guaranteed, he may avail himself of any set off arising out of the same transaction as the debt guaranteed which the principle debtor possess against the creditors.[90] In *Bechervaise v Lewis*[91] the surety who had joined in a promissory note given by the principal as the consideration for the assignment to him of certain debts was permitted to setoff against a demand on the note certain of the debts which had been collected by the creditor but not yet paid over to the principal.

Geraldine Andrews[92] noted that the right of set off does not operate as a defense against the guarantor's own liability but under the guarantee since there is no assignment of the benefit of the principal's cross claim; the surety is not in the position of assignee. What in fact the surety has is an equitable right to be exonerated from liability under the guarantee to the extent of that the principal has a defense to the creditor's claim arising out of cross demands between themselves.

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[87] *J Milnes above n36, 206 Para 18-12.*
[88] *(1925) Ch 132.*
[89] *(1976) Ch 596.*
[90] *Bechervaise v Lewis (1872) LR 7 CP 372. Also Boc Group Plc v Centeon (1999) 1 ALL ER (Comm) 53.*
[91] *Ibid.*
[92] *Ibid note 8 1at p360.*

2.8.1.4 Right of subrogation

A guarantor who has performed the obligations of the principal which are subject of the guarantee is entitled to stand in the shoes of the creditor and to enjoy all rights that accrued to the creditor against the debtor.[93] The guarantor is entitled to the benefit of the creditor's remedies the moment he pays the debt. Thus where he offers to pay debt on condition that those remedies are made over to him, but the creditor refuses he is entitled to pay the money into court and bring an action for an assignment of the remedies.

Sir Samuel Romilly in Craythrone v Swinburne[94] commented that a surety will be entitled to every remedy, which the creditor has against the principal debtor; to enforce every security and all means of payment; to stand in the same place of the creditor; not only through the medium of the contract, but even by means of securities, entered into without the knowledge of the surety; having a right to have those securities transferred to him; though there was no stipulation for that, and avail him or herself of all those securities against the debtor. This right of a surety also stands, not upon contract but upon natural justice; the same principle, upon which one surety is entitled to contribution from another."

This right is exercisable to the extent of the debt owed to the creditor; a surety for part of a principal debt is subrogated to the same rights that the creditor has in respect of that part, and is entitled, on payment of that part, to share *pro tanto* in any security which is given the creditor holds for the entirety of the debt.[95]

2.8.1.5 Right to securities deposited with the creditor After paying off the debt, the guarantor becomes entitled to the securities which have been given for the debt by the principal debtor to the creditor. This right is based on the obligation imposed on the principal debtor of indemnifying the guarantors, which makes it inequitable for the creditor to throw the whole liability on the surety by electing not to avail him or her of the securities for the guaranteed debt.[96]

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[93] *Ibid at 374.*
(1807) 14 Ves 160.
[95] *Goodwin v Gray(1874) 22 WR 312. See Geraldine, ibid n 81 at 379.*
[96] *Aldrich v Cooper (1803) 8 Ves 382. See Milnes, above n36, Para 18- 16, p206.*

This Right extends to all securities which the creditor has received from the principal debtor before or after the creation of the surety ship. Whether or not the guarantor knew of the securities is irrelevant to the claim. In *China & South Sea Bank Ltd v Tan*[97] *Lord Temple man* observed that "as a surety, on payment of the debt, is entitled to all securities of the creditor. Whether he/ she is aware of their existence or not, even though they were after the contract of suretyship, if the creditor who has had or ought to have had them in his full possession or power loses them or permits them into possession of the debtor or does not make them effectual by giving proper notice, the surety to the extent of such security will be discharged.

2.8.1.6 The right to recover the securities deposited (by the guarantor) with creditor

When the debt has been settled by either the guarantor or debtor himself, the guarantor is entitled to have his or her security returned by the creditors.

2.8.2 Guarantor's rights as against the principal debtor

Right to indemnity

Apart from any express contract between the principal debtor and the guarantor if the guarantor gives the guarantee at the express or implied request of the principal debtor, there arises at the time when the guarantee is given an applied undertaking by the principal debtor to indemnify the guarantor in respect of any sums the latter pays under the guarantee.[98] In *Re A Debtor*[99]*Green LJ* observed that in most circumstances an implied request by the principal debtor will be readily assumed. In *Paget's law of banking* it is observed that upon payment of sums due under the guarantee, the guarantor is normally entitled to reimbursement on the alternatives basis that he has been compelled by law to pay or being so compellable to pay has paid money which the principal debtor was primarily liable to pay.[100]

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[97] *(1989) 3 ALL ER 839, 842.*
[98] *Mark Hapgood, above n28, 706.*
[99] *(1937) 1 Ch 156 at 163.*
[100] *Ibid n98*

2.8.3 Guarantor's rights against co-guarantors

Where two or more persons guarantee the same debt whether jointly or severally or jointly and severally, they are co sureties. The law of restitution permits co obliges such as co insurers, co trustees, co contractors to recover contributions from each other should one of them be required by the creditor to pay more than their due share of s common obligation for which they are all liable.[101]

Where there is more than one surety for an obligation and one has paid more than his/ her share of the common liability he/ she is entitled to recover the excess as contribution from his co-guarantors since as between themselves the liabilities of the guarantors ought in equity to be equal.[102] The rationale for the equitable right of contribution is that the creditor should not be permitted to throw the whole burden of the debt on one of the guarantors.[103]

However where there are limits on the liabilities of the guarantors under one or more of the guarantees the due shares of the guarantors are proportional to their respective liabilities, if one of the sureties is insolvent then the shares of the burden that the other sureties must bear increase in proportion to their respective liabilities.

The right of contribution arises against other guarantors of the same obligation whether they are liable under the same or separate instruments. In *Commissioners of The State Saving Bank of Victoria v Patrick Intermarine Acceptances Ltd (in liq)*[104] it was observed that sureties are not only entitled to a contribution from each other for money paid in discharge of their point they are also entitled to the benefit of any security taken by one of them from the debtors in respect of such liability.

According to *Gibbs CJ in Mahoney v MC Manus*[105] "it should be remembered that the doctrine of contribution is based on the principle of natural justice that if several persons have a common obligation, they should as between themselves contribute proportionately in satisfaction of that

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[101] *Geraldine Andrews & Richard Millet, ibid n 81, at 391.*
[102] *Stimpson v Smith (1999) 2 ALL ER 833; Payment must have been made by the guarantor claiming contribution pursuant to same legal obligation.*
[103] *Geraldine Andrews & Richard Millet, ibid n100.*
[104] *(1981) 1 NSWLR 175.*
[105] *(1981) 55 AL JR 673 at 676.*

obligation. The operation of such a principle should not be defeated by too technical an approach to the question whether a surety has paid the creditor, when he has supplied moneys to the principle debtor for the purpose of making such payment."

2.9 CONCLUSION

Much as the guarantors or sureties are availed rights at equity and common law and by the contract, the practice is that many bank guarantee forms are drafted in a way to elude many of these rights leaving guarantors in somewhat a hopeless situation. The banks knowing that defects of guarantees as security often centre around; legal complications of the guarantee form and the rights of the guarantor and the guarantor's financial ability to honor his or her as and when called upon to do so, banks exercise utmost care to protect the bank while cutting down on the rights of the guarantor. Even so, the tricky situations that may unexpectedly arise are handled carefully and correctly by the bank by not suggesting, suitable guarantors, avoiding misrepresenting or even waiving terms of the guarantee; knowing that any material variation may bring the guarantee to an end.

CHAPTER THREE

ANALYSIS OF THE LEGAL REGIME ON GUARANTEES

3.1 INTRODUCTION

In this chapter the research seeks to consider the legal regime governing guarantees, the liability of the guarantors and any conditionalities connected there with. For the law presently applicable does not precisely special conditions in fact it is silent on many issues that affect guarantorship thus homage is paid to the Common law.

3.2 LEGAL REGIME OF GUARANTEES IN UGANDA

There is no concise law on guarantees however when dealing with a matter concerning the guarantees, courts make reference to the following laws.

S 3 of the Contract Act[106] which provides a single requirement of guarantees. The section is to the effect that no suit is maintainable on certain guarantees or representations unless they are in writing and signed by that party chargeable. An important tribute of this Act is that it allows the application of the *English Contract Act.*[107] This is somewhat good contribution in that Court can look out to the progressive English law to fill the loopholes in the Ugandan law.

Surety is defined in the *Mortgages Act 2009*[108] as a person who offers security in the form of money or money's worth to ensure the payment of any monies secured by a mortgage and includes a guarantor.

Who can be surety?

Private persons, body corporate, associations and the government can be sureties and guarantors. The general principles that govern contracts do apply to guarantees. The Government to be a guarantor, the Loans (Guarantee) Act[109] applies. When Parliament has by resolution authorized the Government to guarantee the payment out of the general revenues and other funds of Uganda, or the Consolidated Fund, as the case may be, of the principal of, or of the principal of

[106] *Cap 73 Laws of Uganda.*
[107] *S 2 of the contract Act of Uganda.*
[108] *S2.*
[109] *Cap 273 Laws of Uganda.*

and interest on, any loan specified in the resolution; or, all or any loans made in pursuance of an approved scheme specified in the resolution, the Minister responsible for finance may, in accordance with the terms of, and subject to any conditions or limitations contained in the resolution, guarantee the payment on behalf of the Government; but where any such resolution relates to an approved scheme, the payments so guaranteed shall not in the aggregate exceed a total to be specified in the resolution.[110]

In *Bank of Uganda v Banco Arabe Espanol*[111] court found the appellant liable for the loan extended to the government of Uganda as guarantor and the liability had not been extinguished by frustration. The appellant attempted to avoid liability to the guarantee claiming frustration by change in the economic policies of the principal debtor, further that its liability was limited to complying payment by the debtor.

3.3 THE LIABILITY OF GUARANTORS

The liability of a guarantor is secondary to the principal contract entered into bet when the credit or and the principal debtor. There are two kinds of guarantees; one is a promise by the guarantor which becomes effective if the principal debtor fails t o perform his obligation;[112] *Lord Reid in Moschi v Lep Air services*[113] observed that with regard to making good to the creditor payments of installments by the principal debtor there are at least two possible forms of agreement. A person might undertake no more that if the principal debtor fails to pay any installment he will pay it. That would be a conditional agreement. There would be no prestable obligation unless and until the debtor failed to pay. There would then on the debtor's failure arise an obligation to pay. If for any reason the debtor ceased to have any obligation to pay the installment on the due date then he could not fail to pay it on that date. The condition attached to the undertaking would never be purified and the subsidiary obligation would never arise.

On the other hand, the guarantor's obligation might be of a different kind. He might undertake that the principal debtor will carry out his contract then if at any time and for any reason the

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[110] *Ibid s1.*
[111] *(1997-2001) UCLR 30.*
[112] *Harlsbury Laws of England 4th ed vol 20, Para 180 at 115.*
[113] *(1973) AC 331 at 344- 345.*

principal debtor acts or fails to act as required by his contract, he not only breaks his own contract but he also puts the guarantor in breach of his contract of guarantee. Then the creditor can sue the guarantor, not for the unpaid installment but for damages. His contract being that the principal debtor would carry out the principal contract, the damages payable by the guarantor must be the loss suffered by the creditor due to the principal debtor having failed to do what the guarantor undertook that he would do; in both cases, the guarantor's liability is secondary; (the liability is secondary whenever the promise to be answered for another does not exonerate that other from liability but leaves him primarily liable as was stated in *Mallet v Bateman*[114]

The guarantor is under no liability if the principal debtor's obligation is discharged by performance or other wise, on or before date of performance; the conditional promise never becomes effective in the other there is no breach by the guarantor.

In *General Produce Co v United Bank Ltd.*[115] *Lloyd J* observed that a promise to pay if the principal debtor does not do so, irrespective of any obligation on the part debtor, is not a guarantee for the guarantor's liability where the principal obligation is discharged by the creditor's acceptance o the debtor's breach, or by insolvency.

The creditor cannot before any default has been committed, bring an action against a guarantor to face him set a pair money to provide for the possibility of a debt becoming due from the principal debtor and the principal debtor making default.[116]

Guarantor has a favored position in the legal jurisprudence; guarantor is a favored debtor, he or she is entitled to insist upon a rigid adherence to the terms of his obligation by the creditor and cannot be made liable for more than he has undertaken.[117]

In *Rehema Nakibuka v Bank of Baroda*[118] the plaintiff had personally guaranteed and also mortgaged her land to help a company, Kumar Sports Ltd get an overdraft of 40.000.000/= million from her account with the defendant bank. When the company defaulted the plaintiff was

[114] *(1865) LR 1 CP 163 at 171.*
[115] *(1972) 2 Lloyd's Rep 255 at 258.*
[116] *Harlsbury, ibid n112.*
[117] *Ibid*
[118] *(2002-2004) UCLR 304.*

told to repay the amount, the plaintiff discovered that the defendant had overdrawn an excess amount and to a different company and not Kumar Sports Ltd as stated in the agreement. Plaintiff discovered that although she had guaranteed 40,000,000/=, the defendant had given an overdraft of over 70000000/= and required her to pay back 93000000/=. Plaintiff also found that Kumar Sports Ltd was not the beneficiary of the overdraft. The plaintiff sued for breach of agreement and prayed for discharge in respect of the mortgage and guarantee.

Court held that the guarantee in question limited the plaintiff's liability for the overdraft to a sum of 40000000/=. That the defendant prejudiced the plaintiff's rights under the contract by dealing with a stranger to the contract. This was because although the plaintiff had fronted Kumar Sports Ltd as the borrower the actual beneficiary was of the overdraft was Kumar sports which was a totally different entity from Kumar Sports Ltd, this was a fundamental breach of which destroyed the very basis of the contract. On the basis of the foregoing, the plaintiff was discharged from the obligations created under the mortgage and the guarantee and was not bound to pay the overdraft in question by reason of the defendant's conduct.

In Hole Urban District council v Fidelity and Deposit to company of Maryland / Spencer Deposit Co of Maryland[119] a contractor entered into a contract with the plaintiffs for the execution by him of certain works. The contract did not contain any agreement by the contactor that, in the event of litigation a rising between him and the plaintiffs in connection with the performance of the contract and of his failing in that litigation and being ordered to pay the cost s, he would pay them. The defendants, as sureties for the contractor, gave a bond to the plaintiffs conditioned for hi s contract.

Litigation having arisen between the plaintiffs and the contact was to the performance of the contract, judgment was given against the contractor and he was ordered to pay the costs. The plaintiffs sued the dependant on their bond for the amount of costs. Court held that, as the liability of the contractor to pay the costs arose not under the contract but under the judgment, the defendants were not liable:

[119] *(1916) 1 KB 25.*

The extent of the liability undertaken by the guarantor w ill depend upon the terms of the contract of guarantee. The liability does not need to be co-extensive with that of the principal debtor; but in so far as it exceeds it, it is not a guarantee liability.

Re Moss ex parte Hallet[120]*Darling J* observed that with regard to the appellant's liability to pay interest that he had to prove in bankruptcy, to decide that question must look at the language of the deed. The covenant of the appellant was to pay interest on the principal sum "so long after the day fixed for payment as any principal money remains due under these presents." It is clear that therefore that if no principal money remains due the appellant is under no liability to pay interest.

To ascertain the extent of the guarantor's liability, if any to the creditor, it is necessary to determine the amount and nature of the principal debtor's debt to the creditor and the circumstances in which it arose. Upon ascertainment of the extent of liability, the guarantees are construed strictly to see whether it covers the nature, extent and circumstances of the principal debt sought to be recovered from the guarantor as stated in *Moschi v Lep Air service Ltd supra.*

Guarantor not liable beyond terms of contract

A promissory note given by a principal debtor and guarantor for a definite to be given in consideration of an advance at the date of the note, and not in payment of the balance of an account current between the principal debt or and the credit or, and unless the is presumption is disproved the advance must have been made if the guarantor is to be liable.

A guarantor who guarantees the payment of bill of exchange to be drawn for specific sum is not liable, even if to the extent of that sum, on a bill even for a large sum.

For instance *in Rehema Nakibuka v Bank of Baroda*[121] Court found the plaintiff free from liability as the bank had varied the guarantee without the guarantor's consent. The court held that the guarantee in question limited the plaintiff's liability for the overdraft to a sum of 40000000/=. That the defendant prejudiced the plaintiff's rights under the contract by dealing with a stranger to the contract. This was because although the plaintiff had fronted Kumar Sports Ltd as the

[120] *1905 2 KB 307, 314.*
[121] *(2002-2004) UCLR 304.*

borrower the actual beneficiary was of the overdraft was Kumar sports which was a totally different entity from Kumar Sports Ltd, this was a fundamental breach of which destroyed the very basis of the contract. On the basis of the foregoing, the plaintiff was discharged from the obligations created under the mortgage and the guarantee and was not bound to pay the overdraft in question by reason of the defendant's conduct.

However, a guarantee given to a bank requiring the payment of a given sum will not be discharged by the creditor's subsequently agreeing to require lesser sum from the debtor; nor will a limited guarantee for money lent to a specialized amount be invalidated by the fact of money being lent in excess of that amount, although the guarantor cannot be made liable beyond the amount prescribed by the guarantee. [122]

A guarantee limited to the loan of a fixed sum will not extend the guarantor's liability for continuing payments made after part of that sum has been reimbursed. A guarantor for payment by join purchasers of the purchase money of an estate will not be liable if it appears that one of the purported purchasers is not bound by the transaction.

Whoever the consideration for the guarantor's promise is forbearance to sue, or to continue legal proceedings against, the principal debtor, all stipulations which constitute part of that consideration must be strictly complied wit h or the guarantor w ill no t be bond.

The guarantor's liability can not unduly be extended; the guarantor's liability is united. He will not be liable f or the costs of a fruit less action by the creditor against the principal debtor if the credit or has not given hi m / her no not ice of his intention to sue the principal debt or. When his liability is limited t o fixed sum will not liable for interest on a large sum. [123]

[122] *Harlsbury, ibid n 112 Para 186.*
[123] *Ibid Para188.*

3.4 WHEN LIABILITY ARISES

The guarantor's liability arises when the principal debtor has made default, thus until then liability can not arises / be borne to the guarantor.

In Moschi v Lep Air service[124]court held that since the creditor's acceptance of the debtor's wrongful repudiation of the contract was a right given to the creditors by the law of Contract, the exercise of that right did not discharge the guarantor from liability under the guarantee nor was it a material variation of the contract which extinguished the guarantor's liability. Further the court noted that when creditors accepted the debtor's fundamental breach of the terms of the contract, including those guaranteed as repudiation of the contract, they were entitled to sue the guarantor in damages for the total sum guaranteed except in so far as already settled by payment made by the co, and the measure of damages was that net sum.

To render the guarantor liable the default relied upon must not be due to the creditor's misconduct or connivance considered in *Bank of India v Trans continental commodity merchants Ltd & Patel*[125]

It is not always easy to determine whether in a particular case a default has been committed and on this, precedent can only be suggestive *In Harvell v Foster*[126] it was held that the function of the administrator as such did not cease merely because there had been delivered into his hands the net residue of the estate after payment of all duty, debts, costs, and expenses and on the failure by the plaintiff for the testator's estate and to pay her full amount due, the administrator had failed well and truly to administer according to law within the true meaning of the bond and therefore the defendants were liable as his sureties

A mere error in book keeping by a clerk is not however a default rendering guarantor liable unless of course the guarantee stipulates that it is to be so considered, *Jephson v Howkins*[127]*is the authority on this matter.*

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[124] *(1973) AC 331.*
[125] *(1982) 1 Lloys's Rep 506 at 513 per Bingham J.*
[126] *(1954) 2 QB 367, (1954) 2 All ER 736 CA.*
[127] *(1841) 2 Man & G366.*

On the default of principal debtor causing loss the creditor the guarantor is, apart from special stipulation, immediately liable to the full extent of his obligation, without being entitled to require either notice of the default or previous recourse against the principal or simultaneous recourse against co- guarantors.[128] The rational for this rule was explained in *Moschi v Lep Air service*[129] that it is duty of guarantor to see that the principal pays or performs his duty as the case may be:

Unless a demand upon the principal debtor is necessary in order to establish the principal debtor's own liability to the creditor it is not necessary for the creditor before proceeding against guarantor to request the principal debtor to pay.[130]

It is not even necessary for the creditor to sue the principal debtor though solvent or to take arbitration proceeding against him / her even though the principal contract contains an arbitration clause, unless this is expressly stipulated for in the guarantee.

Modern forms usually require the guarantor to pay on demand: in such a case, a valid demand is a necessary ingredient of the creditor's cause of action against the guarantor. The demand must comply with any requirements imposed by the contract of guarantee as to the form and manner of the demand. Whenever there is no express or implied requirement in the guarantee for a demand and no circumstances rendering a demand upon him a legal obligation, the guarantor is liable without being requested to pay as was stated in *Thomas v Nottingham incorporated football club Ltd.*[131]

In *Allied Bank International Limited v Winfred K Nalusimba & another*[132] The plaintiff filed a suit against the defendants to recover shs 9417,280/=. The debt arose from a loan which the plaintiff advanced to the defendants. The first defendant executed a mortgage to secure the loan, while the second defendant undertook to guarantee the payment for the loan. Following nonpayment of the loan by the defendant, the plaintiff filed a suit to recover the sum. The first defendant did not file a defense and an interlocutory judgment was entered against her. The second defendant denied the claim and alleged that he did not execute the guarantee.

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[128] *Harlsbury ibid n 122, Para 194.*
[129] *supra at 357; 408.*
[130] *Re locky (1845) Ph 509.*
[131] *(1972)Ch 596, (1972) , All ER 1176*
[132] *(2002-2004) UCLR 31.*

Court held that the second defendant's signature on the guarantee was sufficient evidence to prove to show that plaintiff's lawyers made a formal demand to the defendants for payment. court found the plaintiff to have proved the case on the balance of probabilities and judgment was entered in their favor against the defendants jointly and generally.

3.5 CONDITIONS NECESSARY FOR GUARANTOR'S LIABILITY

Any conditions either express or implied precedent to the guarantor's liability must be fulfilled before recourse can be had to him / her.

In Associated Japanese Bank (International) Ltd v Credit du Nord SA[133]it was observed that on the true construction, the guarantee was subject to an express condition precedent that there was a lease in respect of four existing machines. Alternatively, it was reasonable to conclude that the guarantee contained an implied condition precedent that the lease related to existing machines. It followed, therefore that since the machines did not exist the plaintiff bank's claim failed.

In *Stanbic Bank Uganda limited v Atyaba Agencies limited*[134]the issue in this case, the respondent had filed and won *High court Civil Suit No 1197 of 1999* against UCB. UCB lodged a notice of appeal and applied to the High Court for a stay of execution of judgment pending the determination of the appeal. The appellant then signed a guarantee in favor of the respondent undertaking to pay the decretal amount on behalf of UCB if appeal was decided in favor of the respondent. The appellant filed a memorandum of appeal in the *Court of Appeal Civil Suit No69 of 2003* in its own name on behalf of UCB Limited based on alleged merger. The appeal was dismissed on grounds that the appellant had no locus standi since the merger had not yet been legalized.

The respondent demanded for payment under the guarantee but was nor paid by the appellant. The respondent filed an application in the High Court seeking orders to compel the appellant to pay the decretal amount under the guarantee, which application was granted. The appellant therefore filed this appeal to oppose the execution order made against it. Counsel for the appellant argued that the learned judge erred in holding that the dismissed appeal was by UCB

[133] *(1988) 3 All ER 902, (1989) 1WLR 255.*
[134] *(2002-2004) UCLR 10.*

Limited hence declaring it liable under the guarantee. The appellant also argued that the necessary conditions of the guarantee had not yet arisen, and therefore the appellant was not liable under the guarantee. The issues for consideration by the Court were whether UCB Limited filed an appeal against *High Court civil suit No 1197 of1999* within the meaning of the guarantee and whether the appeal was determined in favor of the respondent so as to meet the conditions of the guarantee.

Court of Appeal dismissed the appeal holding that the trial judge rightly held that all the conditions under the guarantee were met. UCB lodged an appeal against the High Court decision, which appeal failed and brought to an end. The failure worked against UCB and worked in favor of the respondent Atyaba Agencies Limited. That the appellant was liable to pay the amount as surety under the guarantee since all the conditions of the guarantee were met.

Where a guarantee recited that the loan to the principal debtor was secured by the charge upon shares which was also mentioned in the operative part of the guarantee, the existence of the security was held to constitute a condition precedent to the guarantor's liability and the guarantor was held not estopped by the recital from asserting the non existence of the shares since the recital was intended as a statement by the creditor and not by him.[135]

Where a guarantee stipulated that the principal debtor is to execute a particular instrument, this will be regarded as a condition precedent requiring fulfillment. However, the guarantor will not be discharged from liability if the principal debtor, although he has or executed the guarantee bond, has executed an instrument on which the guarantor may sue him and become his specialty creditor stated in *Cooper v Evans*[136]

The mere fact that the taking of other security is intended or contemplated by the creditor will not make the taking of that security a condition precedent to the guarantor's liability, unless the guarantor makes the fact that his guarantee is so conditional clear to the creditor before he gives it or there are other exceptional circumstances.

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[135] *Re Parent Trust and Finance Co Ltd (1936) 3 All ER 443.CA*
[136] *(1867) LR 4Eq45.*

The guarantor would not be relieved from liability simply because persons he/she merely thought or assumed would also sign the guarantee have-not done so or further security that he merely thought or assumed would be taken has not been taken reviewed *Ward v National Bank of New Zealand*[137]

Duration of guarantor's liability depends upon the terms of guarantee.

Some guarantees are intended to cover a single credit or transaction only, while other are framed so as to apply to a series of creditor or transactions.

In the cases of a single credit or transaction the guarantor's liability extends only to the one credit or transaction agreed upon , while in the case of continuing guarantee the liability endures till the credits or transactions contemplated by the parties and covered by the guarantee have been exhausted or until the guarantee its self has been revoked.[138]

3.6 VITIATING FACTORS

A guarantee procured by duress by the creditor is liable to be set aside.[139] Duress may take the form of physical coercion or of any other conduct or threat which the law regards as illegitimate and so vitiates his or her consent to the guarantee.[140] In *Mutual Finance Ltd v John Wetton & Sons Ltd*[141]it was observed that where a guarantee is obtained from a family company by threat to prosecute a family member was voidable. This case was argued and decided as a case of undue influence, on the basis that the Common Law Doctrine of duress has been superseded by the equitable doctrine of undue influence.[142]

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[137] *(1883) 8 App Cas 755.*
[138] *Harlsburys ibid n 122 para 198.*
[139] *Harlsburys ibid n122 Para 132.*
[140] *North Ocean Shipping Co Ltd v Hyundai Construction Ltd (1979) QB 705, also found at (1978) 3 ALL ER 1170.*
[141] *(1937) 2 KB 389, (1937) 2 All ER 657.*
[142] *Ibid at 394.*

Undue influence

A guarantee procured by undue influence on the part of the creditor may be set aside.[143] Undue influence can be actual or presumed; in cases of actual undue influence, it is necessary for the claimant to prove affirmatively that the wrong doer exerted undue influence on the complainant to enter into the transaction.[144] In cases of presumed undue influence, the complainant only has to show in the first instance that there was a relationship of trust and confidence between and the complainant and the wrong doer of such nature that the wrong doer abused that relationship in procuring the complainant to enter into the impugned transaction; the burden then shifts to the wrong doer to prove that complainant entered into the impugned transaction freely.[145]

In *Barclays Bank Plc v O'Brien*[146]it was held that where a cohabitee entered an obligation to stand as surety for the debts of the other cohabitee, including the debts of a company in which the other cohabitee but not surety had a direct financial interest and the creditor was aware of that they were cohabitees, the surety obligation was valid and enforceable by the creditor unless the suretyship was procured by duress undue influence misrepresentation or other legal wrong of the principal debtor. If there had been undue influence misrepresentation or other legal wrong by the principal debtor, then unless the creditor had taken reasonable steps to satisfy him or herself that the surety entered into the obligations freely and in knowledge of the true facts, the creditor would be unable to enforce the surety obligation because he or she would be fixed with constructive notice of the surety's right to set aside the transaction. However, unless there were special exceptional circumstances, a creditor would be held to have reasonable steps to avoid being fixed with constructive notice if he or she had warned the surety at a meeting not attended by the principal debtor, of the amount of potential liability and of the risks involved and advised the surety to take independent legal advice.

On the facts in this case, court commented that the bank knew that the parties were husband and wife and should therefore have been put on inquiry as to the circumstances in which the wife had agreed to stand surety for the debts of her husband. The failure by the bank to warn the wife when she signed the security documents of the risk that she and the matrimonial home were

[143] *Harlsburys ibid n122 Para 133*
[144] *Ibid.*
[145] *Ibid.*
[146] *(1993) 4 All ER 417, 432 per Lord Browne- Wilkinson.*

potentially liable for the debts of the company or to recommend that she take legal advice fixed the bank with constructive notice of the wrongful misrepresentation made by the husband to her and she was therefore entitled as against the bank to set aside the legal charge on the matrimonial home securing the husband's liability to the bank.

Similarly in *Ottoman Bank v K S Mawani & Others,*[147] S a third defendant signed a guarantee in favor of the plaintiff bank as further security for advances made by the bank to a firm of merchants of which F (S' father) and M (S' mother) were proprietors. S lived and worked with F and M, was entirely dependant on them, and although of age, was found by the judge to be subject to F's authority and immature. S had no property of his own and had no independent advice before signing. S denied liability when sued by the bank on his guarantee claiming that he signed it under the und influence of F.

Court held that on the evidence of S, he signed the guarantee under the influence of his father and the defense of undue influence succeeded. Rudd, J commented that the defiance of undue influence required more consideration. That although the third defendant is now, and at the time he signed the guarantee was, considerably over the age of majority, he was still very much subject to his father's authority and he did not impress me as a very mature person. He had no property or income of his own. He lived with his father, had no salary, worked in his father's business and we entirely dependant on his father and mother. In fact I think he was very much subject to his father's influence.

3.7 DETERMINATION OF GUARANTEES

A guarantee is determined by:-[148]

a) Repayment by the principal debtor. A distinction is made between a specific guarantee and the continuing guarantee which is the kind the banks take often. A specific guarantee is an undertaking to be responsible if the principal debtor does not repay for an advance of a specified sum or for advances up to an agreed limit. These guarantees are terminated by repayment.

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[147] *(1965) EA 464.*

[148] *F.E Perry; Law and Practice, Relating to Banking; Methuen, Co Ltd, 4th edition, (1983) at pg293.*

With a continuing guarantee covering a running account, the guarantee remains in force not with standing that the account may fluctuate between debit and credit. And the debt has been repaid, and then after a period of credit a further borrowing is contemplated, it is as well to confirm with the guarantor that the guarantee is still available.[149]

A fraudulent preference will have the effect of keeping the guarantor liable although the debt appears to have been repaid. The bankruptcy or liquidation of the principal debtor may leave have the banker with rights against the guarantor.[150]

b) Repayment of the debt by the guarantor. Either the banker will demand repayment from the principal debtor and then call on the guarantor, or the guarantor will give notice of this wish to terminate his liability.[151] In this case the bank will diarize for the last day of the period of notice (informing the principal debtor) and wait for day to arrive. During this time is the banker to exercise supervision over the account on behalf of the guarantor, seeing that only outstanding commitments and essential payments are made? Or is no business of his if, the principal debtor, knowing of the guarantor's decision intends to take advantage of the limit.[152]

There have been conflicting views on the duty of the banker, but the better opinion seems to be that the guarantor must abide by his avoid. He has promised to be responsible for the ultimate balance, whatever that is, the conduct of the account from the time of giving notice to the expiry of the period of notice, is a matter between the principal debtor and his guarantor; the banker is only concerned to see that the top limit is not exceeded.[153]

c) Notice of the guarantor's death

The guarantee is not determined when the guarantor dies but when notice of this event reaches the bank, or should have reached the bank. The usual form of bank guarantee will, however, include an agreement that determination is to be postponed until given by the person

[149] *Ibid.*
[150] *Ibid.*
[151] *Ibid.*
[152] *Ibid.*
[153] *Ibid.*

representatives. This avoids a sudden break in the account which would probably cause inconvenience to the principal debtor and gives time for some alternative security to be found.[154]

d) Notice of mental incapacity of the guarantor. The position here seems to be on all fours with the notice of death. The guarantor can not continue to be responsible for advances made after his death. The only difference appears to be that, curiously enough the banks have inserted no clause delaying determination until a receiver gives notice. This may reflect the small number of guarantors becoming mentally incapable, or it may reflect some uncertainty as to what views the court of protection hold. It is therefore when notice of the mental incapability reaches the bank that determination takes place.[155]

In *Bradford Old Bank v Sutcliffe* [156]it was held that a clause requiring notice of determination by the personal representatives on the death of the guarantor do not apply in the event of lunacy. However as soon as the bank receives notice of the mental incapacity of the guarantor, the bank can longer make advances for which the insane guarantor will be liable.

e) Bankruptcy of guarantor. In the bankruptcy sequence of events, the banker may receive notice of an act of bankruptcy, or his/her first intimation may be a receiving order. Where it is the guarantor of one of his/her customers who has committed an act of bankruptcy, the banker will rule off the account of the debtor on the assumption that the act of bankruptcy will in fact lead to bankruptcy. If may not; but S 33(3)[157] of proving for any outgoings allowed on the principal debtors account after notices of act of bankruptcy. Whatever happens thereafter, the banker's faith in his country will have been shattered, and he is not likely to allow the existing security to continue on the basis even if the guarantor survives the act of bankruptcy.

A receiving order will terminate the guarantee abruptly leaving the bank with the right to prove in the bankrupt's estate for the debt. A contingent liability such as a foreign draft negotiated for the principal. Debtor with recourse, in the process of collection may be proved for (always provided that the total amount for which the guarantor or is responsible is not exceeded.[158]

[154] *Ibid. see also Bradford v Sutcliffe (1918) 2 KB 833.*
[155] *Ibid.*
[156] *(1918) 2 KB 833.*
[157] *Bankruptcy Act of Uganda Cap 67. See S.20 (2) Bankruptcy Act of 1914(England).*
[158] *F.E Perry, ibid n148 at 294.*

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f) Death of the principal debtor. The guarantee will cover cheques drawn by the principal debtor and paid at the bank after his death but before notice of death has reached the bank. Thereafter no more cheques will be paid, any further cheques being returned with the answer "Drawer deceased." The bank will usually wait to see whether the estate can pay off the debt, and then claim on the guarantor for any short fall.[159]

In *Simson v Cooke*,[160] the surety was under a bond to meet sums as should have been advanced to meet bills of two partners in a partnership or by either of them, it was held that this obligation did not extend to bills drawn by one partner after the death of the other partner

g) Mental incapacity of the principal debtor. The account of the principal debtor must be stopped on notice being received of his mental illness, and the guarantor must be advised. Essential cheques for the welfare of the patient, which would normally be paid out of a credit balance in reliance on the approval of the receiver when appointed, should be agreed by the guarantor.[161] Consequently it will be prudent to arrange with him before and how far, within the guaranteed amount, the bank may go.

h) Bankruptcy of the principal debtor. The usual case will be that the bank will stop the principal debtor's account at the date of the receiving order, prove on the bankruptcy estate for the debt and call on the guarantor for any short fall. After receipt of notice of an act of bankruptcy a banker might in the case of a credit account continue to pay cheques to the debtor himself under s. *49*[162] but where the account is overdrawn it must be stopped on notice of the act of bankruptcy because of the effect of S. 45 of the same Act.[163]

Thus in *Re Manson, exp Sharp*[164] where a guarantee had been given to a bank which had knowledge of the principal's act of bankruptcy and then the surety in ignorance of the act of bankruptcy paid the bank to the full extent of his liability under the guarantee without any specific appropriation, it was held that the bank had to apply the payment to the portion of the guaranteed debt which was provable and not to that portion which was not provable.

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[159] *Ibid.*
[160] *(1824) 1Bing 452.*
[161] *F.E Perry, ibid n148 at 294.*
[162] *Supra n157.*
[163] *Ibid.*
[164] *(1844) 3 Mont D& De G 490.*

i) Misrepresentation to the guarantor. The effect of a misrepresentation is to make the contract avoidable at the option of the (innocent) party deceived. The cases show that misrepresentation occurs where the bank has brought an action against the guarantor for payment, and the guarantor has then successfully pleaded that he was deceived as to a material fact at the time he signed the guarantee. In *Mackenzie v Royal Bank of Canada,*[165] *Lord Atkin* observed that a contract of guarantee like any other contract is to be avoided if induced by material misrepresentation of an existing fact even if made innocent.

It is equally possible, if perhaps more likely, that the guarantor may discover during the currency of the contract that he was so deceived and may inform the bank he considers the contract rescinded. It will then be open to the bank to consider his grounds and to challenge them in courts if it becomes necessary.[166]

j) Variation in the composition of the parties. Where the principal debtor is a firm, any change in the composition of the firm determines the guarantee[167] unless the guarantee form covers the point. This section also provides for the same effect if the variation is in the banking firm. In *Dance v Girdler*[168]a guarantor who had given a guarantee in favor of named individuals as governors of a society and their successors was discharged when the creditors as the society became incorporated

Nowadays the variation is likely to be the amalgamation of one joint stock banking company with another rather than the absorption of a banking firm and such a clause, however, the guarantee could be good up to the date of the change but not for any amounts paid after it.[169] Where the guarantor is a firm, any change in the composition of the firm will determine the guarantee; and if it is desired to continue the commitment a fresh form of a guarantee should be taken.

k) Agreement by the banker to give time to principal debtor. A binding agreement of this nature will discharge the guarantor if it is made without his consent, on the equitable ground that the

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[165] *(1934) AC 468.*
[166] *F.E Perry, ibid n148 at 295.*
[167] *Partnership Act, S.18(England).*
[168] *(1804) 1 Bos & PNR 34.*

[169] *F.E Perry, ibid n148 at 295.*

guarantor's subsequent right to claim against the principal debtor has been altered. The passage of time may have made the debtor less able to pay the guarantor. The agreement must be binding one and not mere exercise of discretion on the part of the banker as to when to demand repayment. Usually a clause in the guarantee authorizes the bank to grant time to the principal debtor, so that the guarantor's permission and consent are obtained in advance.[170]

The rationale for the discharge of the guarantor was discussed by *Cockburn CJ in Swire v Redman*[171] "that the relation of the principal and surety gives to the surety certain rights amongst others surety has at any time the right to apply to the creditor and pay him off and then to sue the principal in the creditor's name. We are not aware of any instance in which a surety has in practice exercised this right; certainly the cases in which the surety uses it must be very rare. Still the right has this right, and if the creditor binds him or herself not to sue the principal debtor, for however short a time, he does interfere with the theoretical right to sue in his or her name during such period. It has been settled by decisions that there is an equity to say such interference with the rights of the surety must operate to deprive the creditor of the right to recourse against the surety."

l) Release of the debt by the creditor. Unless a clause of indemnity is included in the guarantee form, a release of the principal debtor will like wise release the guarantor. A partial release may some times occur where the bank, obtaining the best terms which it can, compounds with the principal debtor, but there is certain to be a clause in the guarantee to cover such an eventuality, leaving the guarantor liable for the remainder of the debt. Nevertheless, it is as well to keep him informed of the progress of the negotiations and to obtain his consent, if possible.[172]

Thus *Cozens Hardy MR in Perry v National Provincial Bank of England*[173] commented that it is elementary law that if a creditor releases the principal debtor, of course the surety is released too.

m) Release of security to the principal debtor. If the guarantor pays the debt, he is entitled to any security held by the banker belonging to the principal debtor. Normally the banker would realize

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[170] *F.E Perry, ibid n149 at 296.*
[171] *(1861) 1 QBD 536 at 541.*

[172] *F.E Perry, ibid n148 at 296.*
[173] *(1910) 1 Ch 464,471*

the security and claim on the guarantee for any remainder; but where the security is difficult of realization he might prefer the guarantor to take it over.[174]

It is difficult to visualize any circumstances in which the banker would yield up security to the principal debtor except in return for repayment in full, but if he did he would release the guarantor to the extent of the security. A clause may be inserted in the guarantee to provide against this unlikely contingency.[175] A guarantor may have grounds for complaint; however where the value of security held has depreciated very considerably through negligence of the banker, perhaps where shares are retained against professional advice on a failing market. Where security is released or falls in value in this way, the guarantor may have his or her liability reduced accordingly.[176]

In Wulff v Jay,[177] it was held that the guarantor was discharged from the liability for the creditor having failed to register the deed and to take possession of the mortgaged property since they had deprived themselves of the power to assign the mortgaged property to the guarantor.

n) Notice by all joint and several guarantors. Notice to determine by one of a number of joint and several guarantors will determine the guarantee as far as that guarantor is concerned, as will notice of death of one such guarantor. The remaining or surviving guarantors will continue to be liable; but the banker should mark the occasion by breaking the principal debtor's account and passing future entries through new account, so as to maintain his recourse against the retiring guarantor or the estate.[178]

The guarantee may include a stipulation that notice is to be given by each joint and several guarantor, including the person representatives f a deceased co- guarantor only then will the guarantee be determined all must join in giving notice and it is not open for any single guarantor to bring the guarantee to an end.[179]

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[174] *F.E Perry, ibid n148 at 296.*
[175] *Ibid.*
[176] *Ibid.*
[177] *(1872) LR 7 Q B 756.*
[178] *F.E Perry, ibid n148 at 297.*
[179] *Ibid*

In *Egbert v National Crown Bank*[180] the guarantee provided that it should be a continuing guarantee until the undersigned or the executor or administrator of the undersigned shall have given notice too make further advances on the security. The Privy Council held the guarantee to have remained in force against the guarantors until each and all of them or their respective executors gave notice to determine it

3.8 CONCLUSION

The contractual liability of the guarantor is strictly limited to what the parties agreed. There can rarely be instances in which the guarantor's obligation is overly stretched. Any attempt do so would allow the guarantor to be discharged from liability. It is because of this fact that even in the tricky situations that may unexpectedly arise are handled carefully and correctly by the bank by not suggesting, suitable guarantors, avoiding misrepresenting or even waiving terms of the guarantee; knowing that any material variation may bring the guarantee to an end. The banks make all necessary efforts to minimize the chances of the guarantors avoiding the liability on the guarante

[180] *(1918) AC 903.*

CHAPTER FOUR

ENFORCEMENT OF GUARANTEES IN UGANDA

4.1 .1 INTRODUCTION

A creditor who wishes to enforce a contract of guarantee or indemnity against surety will need to take into account a number of legal and practical considerations before commencing the proceedings. First he| she has to ensure that his| her cause of action has accrued which involves ensuring that all conditions precedent to the surety's liability have been fulfilled. A related matter will be whether the action is not time barred. Further the creditor must address the matter of jurisdiction, this may be some thing which is predetermined in the contract but if not will he need to consider which available forum is the most appropriate for is requirements. Thirdly he | she must ensure that he | she has title to sue and all 5the necessary parties to the action are joined. Finally there may be a number of miscellaneous matters to take into consideration in choosing what type of proceedings he| she should take. These considerations may include the solvency of the surety and the availability assets against which he | she can execute any judgment which he | she may obtain.[181]

These general considerations arise in any case in which a party to a contract wishes to enforce the obligations of another contracting party. In this chapter the aspects of these matters which have special relevance to contracts of suretyship| guarantorship are discussed, together with some of the problems which may arise and a few practical solutions are suggested.

4.1.2 *When the creditor can sue the guarantor*

When the contract upon which the creditor proposes to sue the guarantor is a contract of guarantee, the liability of the guarantor accrues at the earliest when the principal defaults in his obligation.[182] Thus in *Ex parte Gardom.*[183]it was held that the creditor was unable to sue the surety on the guarantee for the period of payment of the price of the goods supplied to the principal before the period of credit allowed to the principal had expired. But the terms of the

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[181] *Geraldine Andrews & Richard Millet, Law of Guarantees, London Sweet & Maxwell, 3rd ed (2000) pg 231.*
[182] *Detailed discussion of the liability of the guarantor or surety was done in chapter 3 of this research.*
[183] *(1808) 15 Ves 286.*

agreement may have the effect that the liability of the surety is to accrue at a later time than default by the principal for example on the creditor demanding payment from the surety.

If a contract of guarantee expressly requires a demand to be made on the surety, the creditor cannot sue the surety until he| she has made such a demand even if the underlying obligation does not require a demand to be made to the principal.[184] *Re Brown's Estate, Brown v Brown*[185]

Similarly if, after the principal first defaults, the creditor gives him | her time to pay with the knowledge of the surety and acquiescence, time will not begin to run against the surety for limitation purposes and the creditor cannot sue him until the extended time for payment has expired.[186]

On the other hand, if the contract is for indemnity, the obligation of the surety is a primary obligation which is independent of that of the principal and it will depend on the terms of the contract whether it arises simultaneously with the obligation of the principal afterwards or even before. Thus it may not be open to the surety to say that because there has been no default by the principal the cause of action has not accrued or will never accrue.[187]In *General Produce Co v United Bank,*[188]

4.1.3 Time of suit

There is no obligation on the creditor to take proceedings against the guarantor promptly or within a reasonable time after the default of the principal in the absence of an express contractual provision to that effect. The surety has to bear the risk that the principal will become insolvent during the period of the delay, making his principal of indemnity worthless.[189] The right of the surety to claim *quia timet* relief against the creditor before demand is made on him | her is therefore a valuable safeguard.[190]Thus in *Thomas v Nottingham Incorporated Football Club,*[191] court held, that where the account was closed and there was an accrued fixed liability a guarantor had a right in equity to require the principal debtor to exonerate him from his liability

[184] *Geraldine Andrews & Richard Millet, ibid n181, 232.*
[185] *(1893)2 Ch 300.*
[186] *Holl v Hadley (1835) 2 Ad & El 758.*
[187] *Geraldine Andrews & Richard Millet, ibid n181.*
[188] *(1979) 2 Lloyd's Rep 255.*
[189] *Geraldine Andrews & Richard Millet, ibid n181, 240.*
[190] *Ibid.*
[191] *(1972) Ch 596.*

by paying off the creditor; that there was no distinction between cases, on the one hand, where under the suretyship contract it was unnecessary to make a demand or where a demand bad been made and those, on the other hand, where a demand was required and was not made; and that, accordingly, the guarantor was entitled to be discharged and exonerated from all liability under the guarantee by the company paying off the debt.

4.2 ENFORCEMENT OF GUARANTOR'S LIABILITY

Under the *Civil Procure Act*[192] the liability of a surety is personal once written notice is expressed to the affected surety. According to *s 93*[193] where any person has become liable as surety shall be personally liable on the decree and shall be deemed a party within s 34 if notice in writing as the court in each case thinks sufficient has been given to the surety. The remedy against a solvent guarantor on his guarantee is by action in the court. The Civil Procedure Act / Civil Procedure Rules provide the procedure in which the creditor may in a proper case recover final judgment against the guarantor in a summary manner.

Jurisdiction in Uganda disputes arising from guarantees are heard by the High Court Commercial Division and equally the parties are free to include ADR in their agreement.[194]However this depends on the quantum of the subject matter.

In *Stanbic Bank Uganda limited v Atyaba Agencies limited*[195]the issue in this case, the respondent had filed and won *High court Civil Suit No 1197 of 1999* against UCB. UCB lodged a notice of appeal and applied to the High Court for a stay of execution of judgment pending the determination of the appeal. The appellant then signed a guarantee in favor of the respondent undertaking to pay the decretal amount on behalf of UCB if appeal was decided in favor of the respondent. The appellant filed a memorandum of appeal in the *Court of Appeal Civil Suit No69 of 2003* in its own name on behalf of UCB Limited based on alleged merger. The appeal was dismissed on grounds that the appellant had no locus standi since the merger had not yet been legalized.

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[192] *Cap 71 Laws of Uganda.*
[193] *Ibid*
[194] *Pecuniary jurisdiction must be followed by the court handling the matter, Section 207 Magistrates Courts Act*
[195] *(2002-2004) UCLR 10.*

The respondent demanded for payment under the guarantee but was nor paid by the appellant. The respondent filed an application in the High Court seeking orders to compel the appellant to pay the decretal amount under the guarantee, which application was granted. The appellant therefore filed this appeal to oppose the execution order made against it. Counsel for the appellant argued that the learned judge erred in holding that the dismissed appeal was by UCB Limited hence declaring it liable under the guarantee. The appellant also argued that the necessary conditions of the guarantee had not yet arisen, and therefore the appellant was not liable under the guarantee. The issues for consideration by the Court were whether UCB Limited filed an appeal against *High Court civil suit No 1197 of1999* within the meaning of the guarantee and whether the appeal was determined in favor of the respondent so as to meet the conditions of the guarantee.

Court of Appeal dismissed the appeal holding that the trial judge rightly held that all the conditions under the guarantee were met. UCB lodged an appeal against the High Court decision. which appeal failed and brought to an end. The failure worked against UCB and worked in favor of the respondent Atyaba Agencies Limited. That the appellant was liable to pay the amount as surety under the guarantee since all the conditions of the guarantee were met.

4.3 ENFORCEMENT OF GUARANTOR'S RIGHTS

There can be an action for indemnification

A guarantor who wishes to enforce his/ her right to indemnity from the principal debtor may bring an action for indemnification in the courts of Judicature. Where the principal debtor expressly agreed to indemnify the guarantor, the guarantor has to sue based on that agreement to enforce the right.[196] Where there is no express agreement by the principal to indemnify the guarantor, the guarantor may enforce his or her right by bringing an action in his or her own name against the principal debtor for the money paid to the debtor.[197]

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[196] *Harlsbury Laws of England, vol 20, Para 253.*
[197] *Morris v Ford Motor Co Ltd (1973) QB 792 at 800, also found at (1973) 2 All ER 1084 at 1089 per Lord Denning.*

If the guarantor and the principal debtor are sued in the same action by the creditor, the guarantor may claim indemnification from the principal by issuing a notice against him or her. If the principal debtor has not been made a party to the creditor's action against the guarantor, the guarantor may join the debtor into by issuing a third party notice against him or her.[198]

In the same spirit, a guarantor who wishes to enforce his right to contribution from co guarantors may bring an action claiming contribution in the courts.[199] To sustain such an action the plaintiff guarantor has to prove that he or she actually paid money or its equivalent and the court will ascertain the proportion of the contribution recoverable. Where one of the co guarantors is left out of the action, still a notice is issued to that co guarantor,[200]

In the actions of enforcement of guarantor's rights, questions of counter claim and set off may arise and courts weigh them so as to mitigate the liability to be borne to the defendant principal debtor or co guarantors.

In *Re Fenton, exp, Fenton,*[201] F having guaranteed advances by certain banks to T association in which he was interested, subsequently executed two deeds of arrangement in favor of his creditors. The association having gone into liquidation, the liquidator lodged a proof against F's estate in respect of sums due by F to the association. The trustee of F's estate rejected the proof and claimed to set off the various sums which had been advanced by the banks to the association for which F had given his personal guarantee. The banks had proved against F's estate under the guarantees but nothing had been paid to them.

The court held that in as much as none of those sums had in fact been paid by F or his trustee to the banks the trustee was not entitled to set off F's contingent liability under the guarantees against the sums due by him to the association

[198] *Third party notice issued under O1 r14 Civil Procedure Rules SI 71-1, Laws of Uganda.*
[199] *Ibid*
[200] *Ibid*
[201] *(1931) 1 Ch 85.*

4.4 PROBLEMS OF ENFORCEMENT

In many cases where the creditor seek to recover money from the surety, he | she will not wish to pursue the principal. For example the principal may be insolvent or outside the jurisdiction and it may be cheaper to and convenient to pursue the guarantor and leave him or her to seek remedy from the principal if he can.[202] In straightforward cases say where it is obvious that the principal defaulted on the repayment of a loan, there are few draw backs to taking this course.[203]

However in some cases there may arise a substantial dispute as to whether the principal was in breach of the relevant contractual obligations so as to give to a claim under the guarantee. The creditor may well consider in terms of tactics, it is preferable to pursue the guarantor alone and leave the guarantor either to try and get the principal to help him by providing evidence to prove that he was not in default or to join him as third party to suit in court to determine the matters connected to the guarantee.[204]

The problems which creditor may face is that the judgment or arbitral award against the principal in favor of the creditor in respect of the relevant debt, default or miscarriage for which the surety is liable is not binding on the surety unless he was a party to those proceedings. *Mercantile Investments & General Trust Co v River Plate Trust, Loan & Agency Co*[205]

4.4.1 Problems of guarantors

a) Guarantors typically give little thought to the implications of signing guaranties, assuming that the loan will be repaid by the primary borrower or through foreclosure of any collateral pledged by the borrower. But the obligation of a guarantor can create a serious risk exposure, so thorough analysis is necessary both before undertaking the obligation and at the first hint of possible default by the borrower.

b) Misunderstandings and misinformation

The litigated cases and results of surveys point to an alarming level of guarantor misunderstanding about many elements of the transaction. In many cases there appeared to be a

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[202] *Geraldine Andrews & Richard Millet, ibid n181, 246.*
[203] *Ibid.*
[204] *Ibid.*
[205] *(1894) 1 Ch 578 at 598 per Romer J.*

fundamental misunderstanding about the way a mortgage, guarantee operates.[206] In consultations with consumer advocates expressed the view that there is low level of understanding about basic concepts such as liability (joint, several or secondary) in the general community and that some people do not understand what a guarantee is at all. It appears there is also a general misunderstanding about the obligations for contribution of co-guarantors.[207]

Mrs A. a sole parent with 8 children, with limited English, was approached by her brother-in-law to be a guarantor for loan of $10,000 to purchase stock for his business. The brother-in-law defaulted and the lender pursued Mrs A, attending her home and threatening to evict her and her children unless she made payments. Upon obtaining legal advice, Mrs A discovered for the first time that: She was in fact a co-borrower and not a guarantor, the loan was for $30,000, and not $10,000, the debt was secured over her home.[208]

The reasons for the many varieties of misunderstanding are complex: it could be that deceit or fraud is involved, or a guarantor's lack of knowledge is not remedied, or that other social or cultural factors impinged on the ability of the guarantor to make an informed decision about signing.[209]

The range of confusion or misunderstanding is evidenced in the cases and study responses: "I thought I was a character reference only for my son; thought I was a guarantor for my daughter and I had no idea it was a co-loan." "I thought that because the business was in both names just thought signature required: didn't know severally liable ... I wouldn't have signed if I knew my liability under the partnership." "Actually I thought I was a co-borrower and not a guarantor. I asked several times for a copy of the contract to see whose name appeared on same. I was not sent one." "I didn't understand any of it, no legal or business mind, all legal stuff that I didn't understand."[210]

Many guarantors were under the mistaken apprehension that they were only signing a guarantee for a limited period of time. Others thought that signing was a mere formality and did not understand that this meant they were putting their homes at risk. Some thought they were merely

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[206] *www.bocsar.nsw.gov.au\lawlink\irc\ll_irc.nsf\pages\lrc_index last checked on 22nd June 2010.*
[207] *Ibid.*
[208] *Ibid.*
[209] *Ibid.*
[210] *Ibid.*

signing a personal overdraft.[211] In review of litigated cases from other jurisdictions indicate that guarantors commonly claimed they were misled by the borrower about the transaction.[212]

If in developed economies like Australia misinformation of such a kind exists, in Uganda, the situation is pathetic, a fact of concern is that many guarantors can not even afford paying for legal advice prior signing guarantees. To one's dismay those who can afford the legal service encounter legal advisers with defective knowledge about the guarantee operation.

This situation can precisely be seen in the case of Stanbic *Bank Uganda limited v Atyaba Agencies limited.*[213]the issue in this case, the respondent had filed and won High court Civil Suit No 1197 of 1999 against UCB. UCB lodged a notice of appeal and applied to the High Court for a stay of execution of judgment pending the determination of the appeal. The appellant then signed a guarantee in favor of the respondent undertaking to pay the decretal amount on behalf of UCB if appeal was decided in favor of the respondent. The appellant filed a memorandum of appeal in the Court of Appeal Civil Suit No69 of 2003 in its own name on behalf of UCB Limited based on alleged merger. The appeal was dismissed on grounds that the appellant had no locus standi since the merger had not yet been legalized.

The respondent demanded for payment under the guarantee but was nor paid by the appellant. The respondent filed an application in the High Court seeking orders to compel the appellant to pay the decretal amount under the guarantee, which application was granted. The appellant therefore filed this appeal to oppose the execution order made against it. Counsel for the appellant argued that the learned judge erred in holding that the dismissed appeal was by UCB Limited hence declaring it liable under the guarantee. The appellant also argued that the necessary conditions of the guarantee had not yet arisen, and therefore the appellant was not liable under the guarantee. The issues for consideration by the Court were whether UCB Limited filed an appeal against High Court civil suit No 1197 of1999 within the meaning of the guarantee and whether the appeal was determined in favor of the respondent so as to meet the conditions of the guarantee.

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[211] *Commonwealth Bank of Australia v Khouri [1998] VSC 128.*

[212] *Micarone v Perpetual Trustee (1999) 75 SASR 1; Fraser v Power (2001) Aust Contract R 90-127; National Australia Bank v Starbronze Pty Ltd [2001] ANZ ConvR 247; Lang v Licciardello [1999] NSWSC 93; Westpac Banking Corporation v Bagshaw [2000] NSWSC 650; State Bank of New South Wales v Hibbert (2000) Aust Contract R 90-119.*

[213] *(2002-2004) UCLR 10.*

Court of Appeal dismissed the appeal holding that the trial judge rightly held that all the conditions under the guarantee were met. UCB lodged an appeal against the High Court decision. which appeal failed and brought to an end. The failure worked against UCB and worked in favor of the respondent Atyaba Agencies Limited. That the appellant was liable to pay the amount as surety under the guarantee since all the conditions of the guarantee were met.

The loss sustained by the guaranteeing bank has to be blamed on the lawyer who was paid to represent the guarantor. how would he have sought of instituting an appeal in the name of the guarantor merely based on a merger being negotiated. Some times as seen indeed lawyers cost their clients a fortune in representation on top of the legal fee charged on the client.

Lack of information about liability or a misunderstanding about the nature of the transaction must be distinguished from cases where the signature was procured in fraudulent circumstances such as forgery. The research found that there was not a simple line that could be drawn between understanding and misunderstanding the transaction; rather there was a wide range of misunderstandings, assumptions, deceptions and half-mistakes that formed a continuum of error. Such errors cover a range of issues including: the period of liability; the amount for which they could be liable; what their role in the transaction actually was (that is, were they are guarantor or a borrower) and whether the loan was secured over property.[214]

Reports on third party guarantees and family relationships highlight the potential dangers for guarantors that arise out of misunderstanding the documents or the transaction.[215] Research confirms that many guarantors sign without an understanding of the nature of the transaction. Guarantors experience both factual and legal misunderstandings about the transaction as a result of misrepresentations, failure to read or understand the documents, lack of competent legal and financial advice, lack of business experience and different cultural expectations.

Guarantors in Uganda; mainly the illiterate and those that can't afford to hire legal service did not comprehend their responsibility to the contract of guarantee. Yet the female guarantors

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[214] *Ibid n 206.*

[215] *Australian Law Reform Commission, Multiculturalism and the Law (Report 57, 1992) at para 11.4. See also the Report of the Expert Group on Family Financial Vulnerability, Good Relations, High Risks – Financial Transactions Within Families and Between Friends Report, (1996) at 10.*

expressed instances of compulsion form their husbands. It is common phenomena for a husband to come home and inform his wife; "honey we shall go to the bank and you will sign some papers." the wife does not get a detailed account from the husband about the documents. Taking it in mind that the banks don't have as duty of care to the intending guarantor, this becomes prejudicial to the guarantors.

In Barclays Bank Plc v O'Brien[216]it was held that where a cohabitee entered an obligation to stand as surety for the debts of the other cohabitee, including the debts of a company in which the other cohabitee but not surety had a direct financial interest and the creditor was aware of that they were cohabitees, the surety obligation was valid and enforceable by the creditor unless the suretyship was procured by duress undue influence misrepresentation or other legal wrong of the principal debtor. If there had been undue influence misrepresentation or other legal wrong by the principal debtor, then unless the creditor had taken reasonable steps to satisfy him or herself that the surety entered into the obligations freely and in knowledge of the true facts, the creditor would be unable to enforce the surety obligation because he or she would be fixed with constructive notice of the surety's right to set aside the transaction. However, unless there were special exceptional circumstances, a creditor would be held to have reasonable steps to avoid being fixed with constructive notice if he or she had warned the surety at a meeting not attended by the principal debtor, of the amount of potential liability and of the risks involved and advised the surety to take independent legal advice.

On the facts in this case, court commented that the bank knew that the parties were husband and wife and should therefore have been put on inquiry as to the circumstances in which the wife had agreed to stand surety for the debts of her husband. The failure by the bank to warn the wife when she signed the security documents of the risk that she and the matrimonial home were potentially liable for the debts of the company or to recommend that she take legal advice fixed the bank with constructive notice of the wrongful misrepresentation made by the husband to her and she was therefore entitled as against the bank to set aside the legal charge on the matrimonial home securing the husband's liability to the bank.

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[216] *(1993) 4 All ER 417, 432 per Lord Browne- Wilkinson.*

This case proves in fact that many guarantors are persuaded to sign without being told the extent and effect of the documents to them, especially women and in any case if told is only required to sign.[217]

Even those guarantors who have counsel seemed not to have appreciated the extent of guarantor's liability. Most times the assumption is the principal will pay the money /loan so no reason to worry about , so guarantor goes ahead to assure the creditor, without reasonable belief in personally being called to meet the liability to the creditor following the default of the principal debtor.[218]

This problem is illustrated by the case of *Bank of Uganda v Banco Arabe Espanol*[219] court found the appellant liable for the loan extended to the government of Uganda as guarantor and the liability had not been extinguished by frustration. The appellant attempted to avoid liability to the guarantee claiming frustration by change in the economic policies of the principal debtor, further that its liability was limited to complying payment by the debtor.

Because of such misguided perception; by the guarantors, when called upon to meet their obligation, attempts are made to dodge about the creditor and often matters are settled by court. At the end of the day, relations become bitter; the guarantor "is left cursing the bankers/ creditor. In the same spirit the guarantors determine their ties with principals alleging to have been "robbed".

In *Allied Bank International Limited v Winfred K Nalusimba & another,*[220]the point in contention above is illustrated. The plaintiff filed a suit against the defendants to recover shs 9417280/=. The debt arose from a loan which the plaintiff advanced to the defendants. The first defendant executed a mortgage to secure the loan, while the second defendant undertook to guarantee the payment for the loan. Following nonpayment of the loan by the defendant, the plaintiff filed a suit to recover the sum. The first defendant did not file a defense and an interlocutory judgment was entered against her. The second defendant denied the claim and alleged that he did not execute the guarantee.

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[217] *Confessions gathered from the field.*
[218] *Ibid.*
[219] *(1997-2001) UCLR 30.*
[220] *(2002-2004) UCLR 31.*

Court held that the second defendant's signature on the guarantee was sufficient evidence to prove to show that plaintiff's lawyers made a formal demand to the defendants for payment. court found the plaintiff to have proved the case on the balance of probabilities and judgment was entered in their favor against the defendants jointly and generally.

It should be remembered that principal debtors of often prefer to choose out close relatives. friends to stand in for their indebtedness; it is right to say that most of the guarantees are guarantees of based on trust. This is done mainly because the debtors feel secure to borrow from those that make them most secured, the debtor in his or her sheer belief never expects the family member to take recourse against him or her.[221]

Once the guarantors have settled the creditor, there is; little or no assistance rendered to the guarantor in pursuing the principal debtor to indemnify / refund the guarantor. Many bank respondents have testified this fact, that what the creditor money debt, "is a mere verbal blessing to the guarantor and the securities possessed it any. This should account for the fact that many guarantors actually never get their indemnification from the principal debtors.

Banks for safety reasons prefer in house customer clients to be guarantors. It is advisable to principal debtor to choose a guarantor who is already a client known to the bank rather than strangers: The rationale for this action is found in the established relationship and trust that exist a between the bank and the intending guarantor. With this kind of operation. the guarantors admitted are less risky to the bank in terms of repayment of loans.[222]

From the field findings most guarantors have failed to recoup their money from the debtors. Many wives who have stood for their husband, have shown how hectic if is to recover their money from the husbands. later on the expectation of the money being the bread winner in the home. such guarantors prefer to let go of the many rather torso out in courts of low which they even find more costly; "better to pay and remain with the peace of mind and harmony in the home"

[221] *Personal emphasis.*
[222] *Field findings*

4.5 CONSQUENCES OF THE PROBLEMS

Because of the way the banks treat their guarantor clients, with the strict rule of secrecy towards the divulgence of information and the minimal support rendered to the guarantor after meeting his / her obligation to the banker, guarantee as form of security in falling considerably. In fact in this study it has been discovered that some banks don't offer the guarantee facility completely while some prefer other alternatives than guarantee. It was found that some banks had admitted guarantors only 10 or less times in financial year.[223]

Such institutions expressed their reasons that guarantors are not easy to come by because of the implications and nature of some unreliable Ugandans. I would beg to differ slightly, though upon entirely for this trend, in my interaction with different responding principal debtor who desired his own brother to guarantee a loan from a micro finance institution, to the dismay of this man, the earmarked brother turned down the request; I don't also have enough money guarantee a loan. This can indeed explain that there is some consciousness growing in the public which explains the unpopularity of guarantees.[224]

The operation of guarantees in Uganda is governed by law sketched from other statutes like the Civil Procedures Act, contract Act; these do not clearly demarcate the corners of guarantees, the absence of a clear law on guarantees presents a grave problem in operation. Little wonder that guarantors make uninformed decisions; they have no proper guidance: Other wise if the proper law were put in place, guarantors could easily predict the consequences and implications of asset to guarantee a debt, weigh his or her rights and obligations. This could harmonize the guarantee law in Uganda as it would indicate the channels and roots to be pursued by a guarantor incase there has been default on the part of principal debtor.

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[223] *The author chooses to reserve revealing the names of the particular banks as he entered into an oath of confidentiality with his respondents.*

[224] *Author's considered opinion about the problem*

4.6 CONCLUSION

The reasons why people enter such risky transactions are not clear cut and cover a range of often intermingled factors including: relationships of trust, feeling a lack of choice, pressure, misunderstanding or optimism. Many such factors are clearly heightened in situations in which the guarantor is economically dependent upon the borrower. The reasons given by guarantors as to why they signed suggest that third party guarantee transactions are being regularly undertaken in situations of power imbalance. These factors suggest that many guarantors could not be regarded as making a free choice to enter into the transaction.

It is important to consult an experienced attorney before signing a substantial obligation, particularly a guaranty of another party's loan. It is absolutely critical to have legal representation by counsel knowledgeable about creditors' rights issues at the first indication that a guaranteed loan may be heading for default.

CHAPTER FIVE

5.1 INTRODUCTION

In this chapter the research sought to explore the possible recommendations, suggestions way forward and make conclusions.

5.2 RECOMMENDATIONS

Suggestions to improve the operation of guarantees

5.2.1 Data centre

There should be a data centre to know about the guarantors. This data centre should particularly be relevant in helping coordinate services of guarantors in Uganda. It is the considered opinion of the researcher that this centre when put in place would increase the bargaining power of the guarantors; this can be stemming from advocacy and sensitization which this research has discovered that are at the core of the successful operation system of guarantees in any jurisdiction.

The credit Reference Bureau recently introduced in Uganda to liaise the credit facilities should be able to assist in this area. I understand it is not easy to achieve this recommendation now since heavy financing will be required, however attempts have been made in other areas: the credit Reference Bureau though recent has shown that it is and will be a success and if streamlined for now to cater for such service to guarantors would help reduce the problems discovered by the research. Moreover there is a close link between the work of the Credit reference Bureau and the guarantees. A coordinated information system among banks should be particularly able to eliminate defaulting clients from the eligible beneficiaries from the facility. But importantly the coordinated information can be the basis for debt insurance as there would be an organized network of beneficiaries.

5.2.2 Relax the requirement of secrecy

Banks conduct a very strict policy on the diligence of information which may be much needed to guarantors so as to make informed decisions. This should be blamed for the unfair treatment

accorded to the guarantors; moreover these financial institutions owe no duty of care to these guarantors.

The law pertaining the secrecy / confidence should be relaxed to assist the guarantors obtain necessary information so as to be able to make informed decisions as to whether to take on the obligation to stand in for the principal debtor. This, if done will be effective in enforcing the rights of the parties to the guarantee in that minimal friction may be involved.

5.2.3 Grant more assistance

The bank should grant more assistance to guarantors in recovering their money. This could be in form of availing legal aid to the guarantors since most banks often admit intending guarantors who are already known clients with a good banking history; one reading this recommendation may imagine am dreaming as I write, amidst the capitalistic cloud which bestows on profit maximization to the banks as laboring under such requirement would increase the burden on the banks. However if this is attempted could be in position to develop a cordial relationship and familiarity to the bank guarantee facility as the clients would be expectant of a warm gesture of appreciation from the bank.

5.2.4 Reknown personalities

Guarantee facilities should be availed only to reknown personalities with good moral financial backgrounds. It is suggested that such persons are informed of their obligation to the contract of guarantee. This is important as it would limit instance of bad relations between the creditors and guarantors if the guarantors are called upon to meet obligation to the bank.

Such personalities should the trustworthy and honest ones of the society, we should not fall for titles as the yardstick for instance giving preference to politicians, religious leaders alone; time has tested some of these persons. This can best be achieved with the presence of data centre to screen the clients.

5.2.5 Sensitization

Sensitization to the general public about the credit facilities available in the banking sector should be undertaken so as to increase awareness to the people. The sensitization could be done through conducting training and seminars with the guarantors so as to enlighten them of the implication, obligations of guarantees and such exercise could assist in screening client's guarantors that are worthy for the facility. This should be able to eliminate the misconception held by the public (guarantors) of not expecting to be called on to pay in default of the principal debtor. This will be even relevant in expanding the banking services in Uganda taking into account that much of the population does not own accounts; will improve on the saving culture among the people.

5.2.6 Role of Central Bank

The Bank of Uganda should interact more with the public and provide civic education about the banking sector. Notable to mention is that the Central Bank merely conducts civic education if there is a proposed currency reform or some thing to that effect. However a powered economy can be achieved if the Central Bank plays a more vital role in the public by updating them of the latest developments in the sector.

Commercial institutions may be much hesitant to take on roles that will hurt them financially; for the commercial banks to venture into this will increase the expenses on these financial institutions. However the Central Bank may be able to undertake such a project for the public good. When done will stimulate the demand of banking services not only guarantees per se.

5.3 WAY FORWARD

Legal responses to the problem of third party guarantee transactions have tended to focus upon the provision of information, usually in the form of legal advice prior to signing. Recommendations have also on occasion focused upon the provision of financial advice or information about the borrower's financial position. While the researcher did not explicitly ask guarantors whether they would have signed regardless of information, warnings or advice, the

following are some of the comments made by guarantors which indicate that for some the execution of the guarantee was, in effect, a forgone conclusion: "being [guarantor] for my daughter, I was not worried one as I was helping her." "sick at the time, didn't want to worry about things so I just signed." "It was for my daughter and I would do anything for my children."

It appears that, for some guarantors at least, they would enter the transaction no matter what they knew about it in advance. In numerous Australian decisions judges have held that, although the guarantor was deceived or misinformed, if they would have signed under any circumstances, then relief should be refused because the misconduct was not the cause of the guarantor's decision to enter into the transaction.[225] Other cases have similarly held that the absence or inadequacy of legal advice would not permit relief if the guarantor would have consented to the transaction regardless.[226] Such an approach has been doubted in decisions in the UK concerning situations where the guarantor was, in addition to such failures, misled. *UCB Corporate Services Ltd v Williams*[227]

However, many respondents to the guarantor survey suggested that more information would have made a difference to their choice: had they been properly or better informed, they may not have proceeded with the transaction. The following are some of the comments from guarantors: "I should have had independent legal advice. I should have had time to discuss the issue with financial/relationship counselors." "More information should be given to people like me ... the lender should make it a rule that someone like me has to go to the bank and be fully aware of their legal rights and what could happen to them." "should explain things more, especially if husband and wife, should have been sat down, should have explained liability clearly."

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[225] *See Commonwealth Bank of Australia v Stavrianos (Unreported, NSW Supreme Court, No 12224/94, Graham AJ, 17 October 1997); National Australia Bank v Mitolo [2002] SASC 102.*
[226] *See Farrow Mortgage Services Pty Ltd (In Liq) v Torpey [1998] NSWSC 114; Sapuppo v Ribchenkov [2001] FCA 1428.*
[227] *[2002] All ER 28.*

5.4 CONCLUSION

Having weighed the operation of guarantees much attention of the law is captured by the creditors who possess the information required in the attainment of their goals. What is expected is that the guarantee should be in writing signed by the guarantor, without undue influence or misrepresentation. These are not enough rather there is need for the conclusive law to govern the rights and obligations of the parties to the contract of guarantee. This will do great service to the guarantors particularly as it would inspire empowerment of informed decision making among the parties

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APPENDIX

QUESTIONNAIRE FOR BANK RESPONDENTS

1. Do you think guarantors are given sufficient protection? Give reasons.

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2. How often does your bank admit guarantees?

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3. Do the guarantors understand the nature of their obligations to towards the bank?

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4. What relationship do the guarantors share with the bank before the guarantee is executed?

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5. How does a client secure the guarantee facility from your institution?

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6. How effective is the current law on guarantees? How acceptable is it to your institution?

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7. Does the law give the bank sufficient cover for the money or loan guaranteed?