Guaranty and Suretyship

(CONCLUDED)

5. THE DEFINITION OF THE CALIFORNIA CODE

The Civil Code of California has a title headed "Guaranty,"¹ which is further divided into two chapters, "Guaranty in General,"² and "Suretyship."³ This certainly implies a distinction between the terms, and if classifications justify inferences of any sort, it ought also to imply that "suretyship" is the narrower term coming within the more general expression of "guaranty."

If we then find in the Civil Code the statement: "a surety has all the rights of a guarantor,"⁴ we ought to understand that to mean that a surety has all these rights, and a few more which a mere guarantor does not possess.

How this accords with the rules laid down in other jurisdictions we need not inquire here. It is important merely to note that the code assumes the distinction to exist and gives it statutory authority.

"Definition" means the delimitation of the thing defined from all other things that would otherwise be confused with it. What are the definitions involved?

Section 2787. "Guaranty, what. A guaranty is a promise to answer for the debt, default, or miscarriage of another person."

Section 2831. "Surety, what. A surety is one who at the request of another, and for the purpose of securing to him a benefit, becomes responsible for the performance by the latter of some act in favor of a third person, or hypothecates property as security therefor."

Except that "surety" is correctly defined as a person and "guaranty" as a thing, the second definition adds only two phrases. One is "at the request of another," the other is the clause "or therefor." If we omit this last since it refers to a special class of transactions, we shall find that the two definitions are precisely the same, except for the phrase "at the request of another." A person who "becomes responsible for the performance by . . . [another] of some act in favor of a third person" is promising to answer for the debt, default or miscarriage of another person in the words of section 2787 and of the Statute of Frauds, from which that section is obviously taken.

As far as the phrase "at the request of another" is concerned, if "another" refers to the debtor in the principal obligation, the expression

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¹ CAL. CIV. CODE Div. III, pt. IV, tit. XIII.
² CAL. CIV. CODE §§ 2787-2825.
³ CAL. CIV. CODE §§ 2831-2866.
⁴ CAL. CIV. CODE § 2844.
is obviously nonsense, since it excludes the common situation in which it is the creditor who procures the surety. If the phrase means either debtor or creditor, which the language really does not admit it tells us nothing except that it excludes a mere volunteer, which we should have known without it.

It is impossible, consequently, to tell from the definitions what the distinction is which the statute implies, except that in those cases in which no personal obligation is entered into but property is hypothecated, we are told that always the transaction is “suretyship” and not “guaranty,” a rule which the courts do not uniformly observe.

It is not a mere matter of phraseology. In California, and other states, important procedural and substantive rights have been held to follow from the distinction, and litigants have lost or won on the assumption that it existed. It is everywhere admitted that the distinction is a hard one and uncertainly applied, but not only the California Code, but most digests and encyclopedias have lengthy sections for both of these relations, as though they were quite plainly separate classes. 

The reality of the distinction is therefore still a practical as well as a theoretical question.

Sections 2787 and 2831 are taken verbatim from the Report of the New York Code Commission of 1865 (Field and Bradford). In this edition, as in our code, the general subject of the title is given as “Guaranty,” under which “Suretyship” appears as Chapter II.

Field’s own notes are as follows. Under section 1534, he writes:

“This definition is in the precise language of the statute of frauds . . . except that it omits the word ‘special’ before ‘promise.’ It of course includes a contract of suretyship, but every guarantor is not necessarily a surety.”

The words leave no doubt that a guaranty is deliberately selected as the more inclusive term of which a suretyship contract is a special example.  

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5 California Jurisprudence, Corpus Juris, and the Cyclopedia of Law and Procedure treat suretyship and guaranty separately. See 13 Cal. Jur. 81-133; 23 Cal. J. 989-1101; 28 C. J. 881-1040; 32 Cyc. 1-307. It is the same with the American Digest. In every one of these collections there is a special section under each rubric giving the difference between suretyship and guaranty.

6 The Civil Code of the State of New York (reported complete by the commissioners of the code, Albany (1865) Division III, pt. IV, tit. XIII. The definition of guaranty is in section 1534 and of surety in section 1556.

7 Cf. Arnold, Outlines of Suretyship and Guaranty (1927) 9-10. “The courts recognize surety to be a more general term than guarantor; and in a statute employing the word ‘surety’ it will generally include guaranty, where there is nothing in the context to limit its application.” Gagan v. Stevens (1886) 4 Utah 348, 9 Pac. 706. Plainly the Field Code does the very reverse of this.
Under section 1558, he says:

"The common definition of a surety (see Webster's, Wharton's and Burrill's Dictionaries), cannot be distinguished from that of a guarantor, and clearly covers the case of an indorser. But an indorser is not necessarily a surety, nor is a guarantor, although their rights are in some important respects alike.

"The distinction between a surety and a mere guarantor is, that the former enters into the contract primarily for the benefit of the debtor, while with the latter the benefit of the principal debtor is no material part of the inducement to him to contract."

How deliberate and intentional the language of the code is may further be seen from the form of the first draft submitted prior to revision. In the first place title XV, part II of division III is in this case headed "Suretyship," which is thus made the general subject, within which chapter II is headed "Guaranty," which thus becomes a subdivision of that general topic.

The wording is quite different. Section 1360 defines a surety as follows:

"A surety is one who becomes liable for the performance by another person of the obligation of such other person, or who assumes an obligation for the benefit of another person and at his request."

Section 1377 has this to say of guaranty:

"A guaranty is a contract of suretyship whereby the surety engages to satisfy the obligation of the principal, if the principal fails to do so himself."

We can therefore trace the history of the code provisions pretty clearly. In the first draft it is hard to see any difference between the two definitions. We can only assume that Field meant there to be a difference and that he then regarded a guaranty as a kind of suretyship contract. In the revised draft, he thinks of suretyship as a kind of guaranty and if the words of the definitions are not quite explicit, his appended notes are, — and it is this revised draft which has been adopted in California.

6. THE FUTILITY OF ATTEMPTED DISTINCTIONS

Doctrinal discussions are not the usual point of approach or departure for the common law, but our text-books profess to be, and usually are, little more than summaries and discriminations of authoritative cases.

In listing these statements I have quoted, except as indicated by brackets, the exact words of the book, but I have rearranged them in order to facilitate reference.

8 DRAFT OF A CIVIL CODE FOR THE STATE OF NEW YORK (Albany, 1862).
Brandt, The Law of Suretyship and Guaranty.\(^9\)

a. "A surety is usually bound with his principal by the same instrument. . . . He is an original promisor."

"The original contract of the principal is not the guarantor's contract.

b. "Usually the surety will not be discharged, either by the mere indulgence of the creditor to the principal, or by want of notice of the default of the principal.

"The guarantor is often discharged by the mere indulgence of the creditor to the principal, and is usually not liable unless notified of the default of the principal.

c. "The principal and surety, being directly and equally bound, may be sued jointly in the same suit, while the guarantor, being bound by a separate contract and only collaterally liable, cannot usually be joined in the same suit with the principal."

Spencer, The General Law of Suretyship.\(^11\)

[Suretyship is said to include in its broadest sense, any form of third party intercession.\(^12\)

a. "A surety, strictly speaking, is one who is bound with the principal . . . by or upon the same contract or instrument."

[By implication, Mr. Spencer holds that a guarantor is bound by or upon different contracts or instruments.]

b. . . . "No notice of the principal's default is necessary to charge the surety . . . nor is he released, ordinarily, by the creditor's delay to prosecute the principal or otherwise to use diligence to collect the debt."

"The strict guarantor . . . is sometimes entitled to have demand made upon the principal and may be released by want of notice of the principal's default."

c. "The surety may usually be sued with his principal, while the guarantor, being bound upon a separate and distinct contract, cannot ordinarily be so sued."

d. [Both are accessory but] "a strict suretyship is a primary and direct undertaking, while a guaranty is secondary and collateral."

e. "The Statute of Frauds applies to [the surety's] undertaking, whereas it is inapplicable if he is strictly a joint promisor, though he is also a surety."\(^13\)

Of all these Mr. Spencer makes it clear\(^14\) that a is far the most important, with the qualification that the courts appear to have in mind not the joint nature of the liability, but the direct and unconditional character of the obligation.\(^15\)

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\(^9\) (3d ed. 1905.)
\(^10\) Section 2, 9 et seq.
\(^11\) (1913.)
\(^12\) Section 1.
\(^13\) Section 3, 3 et seq.
\(^15\) Ibid. 7.
Stearns, *The Law of Suretyship*. 16
[Mr. Stearns uses a17 and b18 as criteria for distinguishing surety and guarantor. He uses d in a modified form, but not c or e. He adds the following:]

f. "A Surety undertakes to pay the debt of another. A Guarantor undertakes to pay if the principal debtor does not or cannot."

g. "A surety promises to do the same thing which the principal undertakes; the guarantor promises that the principal will perform his agreement and if he does not, then he, the guarantor, will do it for him."

h. "The liability of the surety is immediate, [and] starts with the agreement, whereas the liability of the guarantor does not start with the agreement, except as a contingent liability and is established for the first time by the default."

[Mr. Pingrey lists a, b, and h,20 but it is not clear in spite of the repetitions and rather confused statements of section 4, whether he includes any others. He adds another which most of the other textbooks discuss and which most repudiate.]

i. "The surety undertakes to pay if the principal does not; while the guarantor undertakes to pay if the principal cannot; that is, if he is insolvent and unable to pay."

j. "The surety is an insurer of the debt, the guarantor of the solvency of the debtor."

Arnold, *Outlines of Suretyship and Guaranty*. 21
In this most recent treatise on the subject, the author collects most of the distinctions already adverted to.22 Mr. Arnold makes an emphatic statement in regard to the two contracts.

"More frequently the courts confuse the terms surety and guarantor but their undertakings are very different. And it is frequently of great practical importance to be able to distinguish the two where the statute attempts to alter the common law rules as to either one."

But in illustrating the difference, the fullest and culminating quotation23 is from an Alabama case,24 in which after some talk of collateral and principal, the court after all comes back to the distinction between promise to pay if principal does not and a promise to pay if the principal cannot.

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16 (Cook's 3d ed. 1922.)
17 STEARNS, THE LAW OF SURETYSHIP (Cook's 3d ed. 1922) § 6, 5.
18 Ibid. 6.
19 (Joyce's 2d ed. 1913.)
20 PINGREY, A TREATISE ON THE LAW OF SURETYSHIP AND GUARANTY - (Joyce's 2d ed. 1913) 7-10.
21 (1927.)
23 Ibid. 14.
Before we examine these distinctions, it is evident that several of them, together with others which will be noted later in cases, must be eliminated at once. They are examples of the curious habit of defining transactions by their consequences which created the term praepos-tera in Latin. These are b, c, e, and perhaps h. There is no good in telling us how the surety, as opposed to a guarantor, is discharged, what is required to fix his liability, how he is to be sued and what evidence is necessary to prove our case against him, unless we are able to discriminate a surety from a guarantor. It is conceivable, to be sure, that all these matters have been arranged by stipulation between the parties, and that when we find such stipulation we reason back and say that the contract involved was or was not a guaranty. But the point is that such stipulations are rarely made and if they are made, the question at issue would then be decided by the specific agreement and not by the name of the contract. The only situation in which this reasoning back would help us is in cases like the following. If the intercessor stipulated for notice we might infer that he was a guarantor and therefore could not be joined with the principal in a suit. It is to be noted in the first place that courts do not generally draw this inference. If they did, the creditor could easily stipulate for such joinder and we should be exactly where we were before.

 Practically all of these distinctions, including the “preposterous” ones, are frequently made in the decided cases. Much the most popular is the one I have denoted i, to the effect that the surety promises that the principal will pay and the guarantor that he can pay. Mr. Spencer does not mention the distinction and Mr. Stearns jeers at it as meaningless. So far from being meaningless, it is easily the clearest and most readily applied of all criteria, and if it were valid, would enable us to clear away at one stroke the jumble of confusing and vague assertions with which the cases and the books, including Mr. Stearns’, are filled. The Pennsylvania cases were particularly fond of this distinction until the passing of a recent statute, and Pennsylvania played a special role in the history of the entire question.

 Unfortunately this plain and simple test is not valid. It makes every guaranty one of collection, and classes every guaranty of payment as a surety contract. Guaranties of payment are rather commoner today than guaranties of collection, and we should then have a permanent contradiction between the language of commerce and that of the law. But even at so heavy a cost, we should at least have a definite criterion, if the courts had decided to apply it. But in most cases, they have not and have called guaranties of payment, guaranties and not suretyship contracts.
Our best and easiest distinction accordingly, vanishes into smoke as we touch it.

The one which is almost as popular is that marked \(a\). The surety is bound by the same contract as the principal and on the same instrument. This, like the other, is simple, precise and concrete, and, like the other, is worthless, since it represents neither mercantile nor legal usage. It would make it impossible for persons to become sureties before or after the main contract, and it is the common practice for them to do so; and it would rule out guarantors, even of collection, who sign the main contract, and they frequently do. That is, it would convert most existing sureties into guarantors and many guarantors into sureties.

There is another distinction which can be easily applied, if it is sound. This is the one sanctioned by the codes in those states which have adopted the Field codes (California, North Dakota, South Dakota, Montana), and also by the code of Georgia. If the contract is wholly for the benefit of the principal debtor, if the consideration moves entirely to him, it is a contract of suretyship. If the consideration is a separate one from that of the main contract and is in whole or in part for the benefit of the intercessor, it is a guaranty. This would at once remove all compensated sureties into the class of guarantors. Further, we should find it impossible to define "benefit" in any useful fashion. Both the surety and the guarantor have intervened in a contract between two parties. Doubtless they had some purpose to serve. Will the fulfillment of that purpose sometimes be a benefit and sometimes not? The relationship or affection which subsists between the intervener and the principal will not of itself be enough to constitute consideration in either case.

And finally this very difference in regard to consideration is in a whole line of cases and particularly in these very codes treated as a reason for calling the intercessor neither a surety nor a guarantor, and withdrawing his contract wholly from the operation of the Statute of Frauds.

As to the other distinctions attempted, it is hard to speak of them with patience. Suretyship involves a "direct, original, immediate, primary, absolute" obligation. Guaranty is "indirect, secondary, collateral, conditional." Apart from the fact that guaranties are often called "original," "primary" and "absolute," and sureties frequently asserted to be "collateral," it is impossible to apply these adjectives, except as already indicated, so that they help us to tell the surety hawk from the guaranty handshaw. What is more original about the surety's contract than about the guarantor's,—or more direct? In either case he
either did or did not make the promise and we must look to his words and conduct to determine whether he did obligate himself and to what extent, just as we must in the case of the principal debtor. What can "immediate" mean in this connection? Either the obligation arose "immediately" when the surety or the guarantor made his promise, or it never arose. As for "absolute" and "conditional," in one sense both promises are absolute. Both promises undertake that the creditor shall receive the performance to which his claim entitles him or its equivalent, just how depends upon the more precise terms of the undertaking.

We may illustrate by the two persons who are concededly most alike, and yet are declared to be in some mystical way wholly different, the "absolute guarantor for payment" and the surety. It is said that the surety owes the amount of the bond just as well as the principal. The principal's default is his default. The guarantor's obligation, on the contrary, is not fixed until and unless the principal defaults. The guarantor's default does not begin until after the principal has defaulted. But will this stand examination? Default creates a cause of action. It is obvious that the creditor cannot sue the surety until the day after performance is due and on the same day and not before, he can sue the guarantor. And if the principal performs, neither surety nor guarantor is liable.

The difference consequently is neither substantial nor even "formal," as some cases have stated, but merely verbal. Shall we leave it there and assert with solemnity that we shall hold men to their words and that they are guarantors when they say they are and sureties when they call themselves so? It may be said that no test has been more uniformly rejected than this one—and rightly. We should be completely at a loss in the majority of cases—those in which neither word is used. We should be indulging in the absurd fiction that business men knew the full legal implication of words which lawyers and courts have not succeeded in defining, and we should be introducing rigidity of interpretation in contracts which more than others, call for freedom and flexibility.

If the cases and the books do not give us a distinction to which we can hold, will the light of reason help us? Is there anything which can be urged to justify the maintenance of the distinction? Does it serve any purpose that there should be a difference between the contract of suretyship and guaranty?

It is conceded that both contracts are alike intended to secure an obligation of A to B by adding to A's credit that of C. The mere fact that B has in either case a choice of one of two persons from whom he can make his debt, does not quite prove that there could not be two
wholly different ways of securing this result. Indeed, it could have been effected by having $A$ make a note to $B$ and having $C$ indorse it. $C$ being an accommodation indorser would have the rights of a surety or a guarantor, but he would be an indorser as well, and a commercial purpose is served in treating him as an indorser in the sense that the claim against him is transferable by negotiation and not by mere assignment. Since negotiation is one thing and assignment is another, and as two different commercial ends are served by them, we cannot treat the distinction as idle.

But what is served by creating a difference between a surety and a guarantor of payment, between two persons who both lend their credit to the same debtor, who become subject to suit in exactly the same situation, to exactly the same extent? And equally what can be gained by distinguishing in terms between a surety who stipulates that the remedy against the principal must first be exhausted, and a guarantor of collection? It is obvious that under some situations both sides may choose or not choose that the claim against the intercessor be postponed, until that against the principal is shown to be worthless. But they can reach this result either by guaranty or suretyship.

And yet, to this distinction which no test can enable us to make consistently, and which serves no purpose that we can assume the contracting parties to have, serious consequences are attached. Courts profess to find that one contract is a guaranty and another a surety and apply grave procedural disabilities in one case or another. In those jurisdictions in which a guarantor may not be joined and a surety may, the distinction means substantial losses in litigation and long postponements which often have enabled the Statute of Limitations to run or otherwise rendered further attempt at relief futile. In California, there is the added difference that if the obligation is secured both by a mortgage and by personal securities, the surety cannot be sued without foreclosing the mortgage, but the guarantor can.

We need lay no stress on the consequences of the distinction as to notice and exhaustion of remedy against the principal. The reason for trying to distinguish between a surety and a guarantor is generally to determine whether or not the intercessor is entitled to notice or whether the principal must be sued first. But that, as a matter of fact, is determined, as it should be, by conclusions about the intentions of the parties in the matter, based in most cases on such knowledge of mercantile custom as the court possesses.

That is to say, the distinction so widely insisted upon and from which such serious consequences are drawn, is no better grounded, when we discard its historical development and seek to base it on a
present or future rational functioning. It is in the highest degree un-
fortunate that the decision of any case should be allowed to turn upon
the whimsy of a Pennsylvania or Massachusetts judge of nearly a cen-
tury ago. It has no roots in the past. It has no sense in the present.
If it is disregarded—as it is in many jurisdictions—it will clear the sub-
ject of a portentous amount of confused phrases and economize effort in
investigating, besides avoiding the obvious injustice of refusing or
granting relief on so insubstantial a basis.

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