

GUARANTOR LIABILITY IN COMMERCIAL LENDING: WHEN CAN GUARANTORS BE RELEASED FROM THEIR LIABILITY UNDER CONTRACTS OF GUARANTEE?

A guarantee is a binding promise from one person (the guarantor), to be answerable for the debt or obligations of another (the debtor or borrower), if that other person defaults. The creditors to whom the guarantees are issued include commercial banks, Savings and Credit Cooperative Organizations (SACCOs), or even suppliers offering goods on credit. Contracts of guarantee take various forms and create legally binding obligations. They attach immediately there is default by the debtor/borrower and as such can have serious financial consequences on the guarantor. *(Our earlier articles on this can be accessed here)*

Are there circumstances in which liability under contracts of guarantee can be avoided? This article seeks to answer this question and also highlights best practices for both guarantors and lenders to help them navigate these relationships with greater clarity and protection.

THE ROLE OF GUARANTORS IN COMMERCIAL LENDING

A guarantor plays a crucial role in enhancing the lender's confidence and reducing credit risk. Whether it is a loan or a supplier credit agreement, lenders often require a third party to guarantee the borrower's obligations. This added assurance gives the creditor additional comfort in extending the credit even where the borrower's financial strength or collateral is seemingly insufficient. The guarantor's commitment creates a binding obligation, one that can be enforced independently of the borrower once default occurs.

While a guarantee is a secondary obligation that kicks in only if the borrower defaults, once such default happens, the creditor can:

- Demand full payment of the guaranteed amount from the guarantor;
- Sue the guarantor independently of the borrower; and/or
- Enforce the guarantee without first exhausting other remedies, unless the guarantee says otherwise.

This means that even if guarantors receive no direct benefit from the loan or transaction, if there is a default, they are liable for the guaranteed amount jointly and severally with the debtor.

WHEN CAN GUARANTORS BE RELEASED FROM THEIR LIABILITY UNDER CONTRACTS OF GUARANTEE?

As pointed out in our earlier article, the principles of contract regulate contracts of guarantee.

However, while a guarantor's obligation is typically enforceable once the borrower defaults, the law anticipates certain circumstances that may justify releasing a guarantor from liability. This doesn't mean that guarantors can walk away at will, but it does mean that there are instances when liability under contracts of guarantees can be avoided. Kenyan courts have pronounced themselves on the subject issue over time and below we look at the legal and equitable grounds which courts have held warrant interference with contracts of guarantee allowing a guarantor to avoid or reduce their liability. Understanding these scenarios is essential for both guarantors seeking protection and creditors aiming to enforce their rights effectively. However, of importance to note is that each case is different, and the wording of the contractual documents is a key determining factor as the courts' obligation is to interpret and give effect to them.

1. Material Variation of the Principal Contract Without the Guarantor's Consent

If the terms of the underlying loan or credit agreement are substantially changed without the guarantor's knowledge or approval, the guarantee may be discharged. For example, increasing the credit limit, extending repayment terms, and/or substituting the collateral. Such changes may be seen as altering the risk the guarantor originally agreed to.

The Court of Appeal in the case of ***David Harris v Middle East Bank Kenya Limited & 3 others [2019] eKLR*** addressed this and held as follows; *"What this means in effect is that the guarantor* ***may be discharged from a guarantee where there has been a variation of the original facility to which he has not been privy****, and has not consented, thereby extending time to pay will result in the guarantor being discharged from the original guarantee agreement."*

In discharging a guarantor from his obligations, the High Court in ***Eldoret Civil Suit No. 37 of 2019 William Kimutai Kandie (suing through John Kamar vs. Consolidated Bank of Kenya Limited & Anor)*** stated thus:

> "... it was significant that the nature of the facilities were converted from 12 months' overdrafts and invoice discounting to term loans in the names of the individual guarantors. I am therefore satisfied that the ***restructuring fundamentally altered the initial obligations as conceived and committed to by the parties and therefore ought to have been done with the participation and consent of the plaintiff***. In any event, the ***plaintiff not having participated in the restructure cannot be held to account on those altered terms***. Consequently, it is my finding that the restructure has the effect ***of fully discharging the plaintiff from his obligations as a guarantor for purposes of the initial Letter of Offer as well as the subsequent Letter of Offer dated 7 November 2012***. I therefore find merit in the plaintiff's case and would allow the same with costs..."

Further, in ***HALSBURY'S Laws of England, Fourth Edition, Volume 20 (1) para 324 page 210*** it is explained that; *"The basis of the principle that a guarantor is discharged by an agreement between the creditor and the principal debtor which has the effect of varying the guarantee, is that it is the clearest and most evident equity not to carry on any transaction without the privity of the guarantor, who must necessarily have a concern in every transaction with the principal debtor, and who cannot as a guarantor be made liable for default in the performance of a contract which is not the one the fulfillment of which he has guaranteed."*

Put simply, any significant change that heightens or shifts the guarantor's exposure can invalidate the guarantee unless the guarantor expressly agrees to it. Lenders should therefore seek written consent before altering loan terms, and guarantors should insist on being notified of, even minor amendments. However, of importance to note is that the wording of the contractual

documents is a key determinant on whether or not such a variation should lead to the liability being avoided.

2. Existence of vitiating factors - Misrepresentation, Fraud, or Duress

If the guarantor was misled, not given the full facts, or duressed into signing the guarantee, the court may set it aside. This applies whether the misrepresentation came from the creditor or from the borrower. Under contract law, any contract entered into through fraud, misrepresentation, or undue influence can be avoided, and guarantee agreements are no exception. Where a guarantor can prove they were induced into signing the contract of guarantee by false information or that key terms were deliberately concealed, the guarantee may be rendered unenforceable. Courts take a strict view of such conduct, especially where it results in the guarantor unknowingly assuming significant financial risk.

3. Impairment or release of Security without Guarantor's Consent

Creditors often secure loans with collateral, such as land, motor vehicles or other assets. When a borrower defaults, the creditor has the right to realise this security to recover the owed amount. In respect of formal charges as security, Section 97(1) of the Land Act creates a chargee's (lender) duty of care to among others, guarantors, when exercising the power to sell charged land by obtaining the best price reasonably obtainable at the time of sale. At sub section (5) of section 97, the Act provides that where the Lender breaches the said duty of care, then it would not be entitled to any compensation or indemnity from the chargor, any former chargor or any guarantor in respect of any liability arising from breach of the said duty of care.

As such, if the creditor acts negligently in respect of security provided by the debtor, guarantors may have grounds to contest or limit their liability. In the case of ***Home Afrika Limited v Ecobank Kenya Limited (Insolvency Cause 010 of 2021) [2023] KEHC 1802 (KLR)*** which attracted huge attention and criticism at the time, the Court pronounced itself on the said sections 97 (1) & (5) as follows:

> *"41. The Court's understanding of the above provision is that the Respondent is not entitled to any compensation in the event that it is not in a position to recover the sums advanced during an exercise to sell the charged property and in this case the Respondent was granted leave to purchase the charged property. The Respondent cannot therefore purchase the said property and still go after the guarantors to recover the sum owed."*

This underscores the importance of creditors exercising due diligence and fairness when realising, dealing or enforcing security. Negligent actions not only jeopardise the recovery process but also risk discharging guarantors from their obligations.

4. Lack of Proper Execution and/or non-compliance with the requisite Formalities

For a guarantee to be legally enforceable in Kenya, certain formalities must be strictly observed. The law and in particular Section 3(1) of the Law of Contract Act (CAP 23) requires that a guarantee be in writing, signed by the guarantor or someone lawfully authorized by them. Further, being a contract, all elements of a contract have to be met for the contract of guarantee to be binding including consideration.

In today's fast-paced commercial world, informal promises shared verbally or through casual messaging platforms like WhatsApp, are common. However, such promises don not meet the legal threshold for enforceability. Creditors should therefore ensure that guarantees are properly documented and executed, while guarantors must avoid committing to obligations without formal agreements. Adhering to proper legal procedures protects both parties and significantly reduces the risk of potential disputes.

5. Repayment or Settlement of Debt

If the borrower pays off the debt, the guarantee being a secondary contract stands discharged. The guarantor cannot be pursued further. Further, if the guarantee is for a fixed time, or is linked to a specific contract, it automatically lapses once the period expires or the contract is completed. Creditors cannot enforce the guarantee for unrelated or future debts unless clearly agreed.

BEST PRACTICES FOR BOTH CREDITORS AND GUARANTORS

For Lenders:

- Ensure the Guarantee is in Writing and Properly Executed;
- Notify guarantors of any changes to the loan terms;
- Exercise Reasonable Care in Realising Security;
- Clearly Define the Scope and Extent of Liability; and
- Get legal advice to ensure properly drafted contracts of guarantee.

For Guarantors:

- Insist on Full Disclosure before signing a Guarantee, especially on amount, duration and scope;
- Never sign a guarantee you don't fully understand;
- Avoid Informal or Verbal Commitments;
- Request for written updates on the performance of the Principal Debt;
- Get legal advice before signing guarantees.

CONCLUSION

Guarantees remain essential in commercial lending, but they are not without legal complexities. From how they are structured and executed, to the circumstances that can discharge liability, both lenders and guarantors must navigate this area with care. Ultimately, well-drafted guarantees, informed parties, and adherence to legal principles help minimise disputes and ensure that credit arrangements serve their intended purpose with fairness and accountability. To avoid costly pitfalls, parties should always seek legal advice before entering into or enforcing a guarantee.

HOW CAN WE HELP?

The **Debt Recovery Restructuring and Insolvency** team at **CM Advocates LLP** prides itself in having a wide variety of resources, skills, and experience on enforcement of guarantees, Realization of charged securities, Hire Purchase Debts and Asset Repossession. We are practical and innovative in our approach and offer quick turnaround timelines. We will be delighted to receive your feedback and inquiries and offer our services in this and any other of our practice areas.

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