

2. INDEMNITY AND GUARANTEE

QUESTION - WISE ANALYSIS OF PREVIOUS EXAMINATIONS

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CHAPTER OVERVIEW

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SECTION 1: THEORY FOR CLASSROOM DISCUSSION

Contract of Indemnity and Guarantee are the special types of contracts given under Sections 124 to 147 of the Indian Contract Act, 1872. Both the contracts are modes of compensation based on certain similar principles. However, both differ from each other on several issues.

CONTRACT OF INDEMNITY AND GUARANTEE (SEC 124 TO 147)

Q.No.1. Write about contract of Indemnity? What are the features of indemnity contracts? (B)
(NEW SM, OLD SM, OLD PM, N98, M99, M01 - 5M, N08, N09 - 1M)

DEFINITION [SEC. 124]:

- 1) A contract by which one party promises to save the other from loss caused to him
 - a) By the conduct of the promisor himself or
 - b) By the conduct of any other person
 is called "Contract of Indemnity"¹.
- 2) Contract of Indemnity² is a form of contingent contract³.

PARTIES:

- 1) **INDEMNIFIER:** The party who promises to save the other party from loss is known as 'Indemnifier'.
- 2) **INDEMNIFIED:** The party who is promised to be saved against the loss is known as 'indemnified' or 'Indemnity Holder'.

Ex: A and B claim certain goods from a railway company as rival owners. A takes delivery of goods by agreeing to compensate the railway company against loss in case B turns out to be a true owner. There is a contract of Indemnity between A and the Railway company. In this case A is called Indemnifier and the Railway Company is called Indemnified or Indemnity holder.

FEATURES OF INDEMNITY CONTRACTS:

- 1) **VALID CONTRACT:** Just like any other contract, A contract of indemnity must satisfy all the essentials of a valid contract like Free consent, Competent parties, Lawful object, etc.
- 2) **CONTINGENT CONTRACT:** The contract of indemnity assures to indemnify the loss. So, its performance is contingent upon incurring of such loss by the indemnity holder.
- 3) **EXPRESS OR IMPLIED:** A contract of indemnity may be expressed or implied⁴ from the circumstances of each case.

SIMILAR QUESTIONS:

- 1) Define contract of indemnity as per Indian contract Act, 1872. What are the parties to the contract of indemnity? Give an example to explain the contract of Indemnity. MTP-N18(N)
- A) Refer above answer
- 2) X, a shareholder of a company lost his share certificate. He applied for the duplicate. The company agreed to issue the same on the term that X will compensate the company against the loss where any holder produces the original certificate. Is there a contract of Indemnity.
 - A) Yes. The contract of indemnity is between X and the company.
 - 3) X, a shareholder of a company lost his share certificate. He applied for the duplicate. The company agreed to issue the same on the term that X will compensate the company against the loss where any holder produces the original certificate. Is there a contract of Indemnity.
 - A) Here, there is contract of indemnity between X and the company.

- 1) Mr. X contracts with the Government to return to India after completing his studies at University of Cambridge and serve the Government for a period of 5 years. If Mr. X fails to return to India, he will have to reimburse the Government. It is a contract of indemnity
- 2) The term Indemnity means to make good the loss or to compensate the party who has suffered some loss.
- 3) X may agree to indemnify Y for any loss or damage that may occur if a tree on Y's neighbouring property blows over. If the tree then blows over and damages Y's fence, X will be liable for the cost of fixing the fence.
- 4) X an auctioneer sold certain goods at the instructions of Y. Later on, it is discovered that the goods belonged to Z and not Y. Z recovered damages from X for selling his goods. Here, X is entitled to recover the compensation from Y because there was an implied contract to compensate the auctioneer.

4) A asks B to beat C, promising to pay him against the consequences. B beats C and is fined with Rs. 1000. Can Promise of A be enforced? Will your answer be different in case A asks B to kill C?

A) No. Since the object of the agreement is illegal it can't be enforced. Just like any other contract, Contract of Indemnity shall also satisfy all the essential elements of a valid contract as stated in Section 10.

The answer remains same as killing a person is also an illegal activity.

5) The contract of Life insurance is not fully covered under the contract of indemnity. Comment. Would your answer different in case of General Insurance?

A) Statement is correct.

Contract of Indemnity includes loss occurred due to act of Promisor or some other person. Generally, loss occasioned by conduct of the Promisee, or accident, or an act of god is not covered. But, if this strict view were to be accepted, a large number of insurance transactions shall not be covered under a Contract of indemnity.

Contract of Life Insurance is enforceable when the insured person is died; the concept of indemnity is to compensate the loss suffered by the insured person. However, Life of the insured person will never be compensated as one can't make deceased insured person alive. So Contract of Life Insurance is never a Contract of Indemnity.

In case of general insurance answer is different and it tantamount to contract of Indemnity.

6) Whether Contract of Indemnity covers the cases of Loss caused by the events or accidents which do not depend upon the conduct of the Promisor or any other person?

A) If the definition of the contract of Indemnity is strictly interpreted, it covers the cases where loss is caused by the conduct of the promisor himself or by the conduct of any other person. In other words contract of Insurance is outside the scope of Contract of Indemnity

Example: Mr. A and Mr. B are friends since childhood. Mr. A asked Mr. B to start a business. Out of fear of losses, Mr. B denied the offer of the Mr. A. Mr. A promised Mr. B that he will compensate Mr. B for any loss arising out of doing business. In the 1st year Mr. B did business and suffered 1,00,000 loss. Mr A indemnified Mr. B for the suffered loss. In the 2nd year Mr. B did business and suffered Rs. 2,00,000 loss. Mr A once again indemnified Mr. B. In the 3rd year, a fire accident happened in the business premises and Mr. B suffered a loss of Rs. 5,00,000 . Now Mr. A is not responsible for the loss happened by way of fire accident which is not covered in terms of indemnity contract.

Q.No.2. What are the rights of indemnity-holder when sued against the indemnifier in the contract of indemnity? (B) (NEW SM - TYK, OLD SM)

First write what is Contract of Indemnity and who is Indemnity holder.

RIGHTS OF INDEMNITY HOLDER (Sec 125):

Indemnity holder is entitled to recover the following, from the Indemnifier (Promisor):

- 1) **Damages in Suit:** All damages which he may be compelled to pay in any suit in respect of matter covered under the contract⁵.
- 2) **Cost of Suit:** All costs which he has paid in bringing or defending the suit provided that -
 - He acted under the authority of the Indemnifier
 - He did not contravene the orders of the indemnifier
 - He acted in such a way as a prudent man would act in his own case
- 3) **Sum paid for compromising suit:** All sums which he has paid under the terms of any compromise of suit provided that -
 - He acted under the authority of the Indemnifier.
 - He did not contravene the orders of the Indemnifier.
 - He acted in such a way as a prudent man would act in his own case.
- 4) **Sue for Specific performance:** If the indemnity holder's liability becomes absolute, he is entitled to call upon his indemnifier to save him from the liability and to pay it off.

5) A promises to compensate X for any loss that he may suffer by filling a suit against Y. The court orders X to pay Y damages of Rs. 10,000. As the loss has become certain, X may claim the amount of loss from A and pass it to Y.

RIGHTS OF INDEMNIFIER: There is no provision in the Indian Contract Act about the Indemnifier's rights. However, the rights of the Indemnifier are same as the rights of a Surety.

SIMILAR QUESTIONS:

- 1) A may contract to indemnify B against the losses of business which B may start at the request of A. After completion of a year, B suffered huge losses in that business. B approached A for indemnity. A rejected the claim; subsequently B filed a suit on A for indemnification. In the process of bringing suit against A, B incurred expenses like lawyer fees, court fees. Is B entitled for costs that are incurred in filing suit?
- A. B can get reimbursement of losses from A provided he has done the business according to the directions of A. B can also get reimbursement of expenses which he incurred in bringing suit for recovery of compensation from A.
- 2) Hell Laptops limited (manufacturer) may contract to indemnify Hell Laptop authorized dealer (Delhi) against the damages in the goods sent to later for the purpose of sale. Hell Laptop authorized dealer (Delhi) sold a laptop to Mr. C (customer) which is a damage piece. Mr. C filed case on Hell Laptop authorized dealer (Delhi) in a consumer court for recovery of laptop price. Hell Laptop authorized dealer (Delhi) paid Rs. 50,000 to the customer in compromising the suit. Now discuss the rights of Hell Laptop authorized dealer (Delhi) in respect of amount paid to Mr. C as per Indian contract act, 1872.
- A. Hell Laptop authorized dealer (Delhi) can get indemnification from Hell Laptops Limited for the sum paid in compromising the suit.
- 3) Ram, an auctioneer, sold certain goods on the instructions of Raj. Later on, it is discovered that the goods are belonged to Rahim. Rahim recovered damages from Ram for selling his goods. Discuss the rights of Ram?
- A. There is an implied contract of Indemnity between Ram (Indemnified) and Raj (Indemnifier). Hence, Ram in entitled to following rights.

Now write the rights of Indemnified as stated above.

Q.No.3. What is meant by Contract of Guarantee? State the Essentials features of contract of guarantee. (Sec 126) (B) (NEW SM, OLD SM)

MEANING: A contract of guarantee is a contract to perform the promise made or discharge the liability incurred by a third person in case of his default.

Ex: When A requests B to lend ₹ 10,000 to C and guarantees that C will repay the amount within the agreed time and that on C failing to do so, he (A) will himself pay to B, there is a contract of guarantee. Here, B is the creditor, C the principal debtor and A the surety.

PARTIES: In a contract of guarantee there will be 3 parties.

- 1) **Surety:** The person who gives the guarantee (In the above example, C).
- 2) **Principal Debtor:** The party in respect of whose default the guarantee is given. (In the above example, B).
- 3) **Creditor:** The person to whom guarantee is given (In the above example, A).

ESSENTIALS / DISTINGUISHING FEATURES OF CONTRACT GUARANTEE:

- 1) **Tripartite Agreement:** A contract of guarantee is a tripartite agreement between the Principal Debtor, Creditor and Surety⁶.
- 2) **Concurrence:** A contract of Guarantee requires the concurrence (consent) of all the 3 parties to it viz. Principal Debtor, Creditor and Surety⁷.
- 3) **Essentials of a Valid Contract:** A contract of Guarantee must have all the essential elements of a valid contract. However, the following points should be noted:
 - a) The Principal Debtor need not be competent to contract⁸. Even if Principal Debtor is incompetent to contract, the guarantee is valid. But, if surety is incompetent to contract, the guarantee is void.

- 6) From the above definition, it is clear that in a contract of guarantee, there are three contracts
 - a) A principal contract between the Principal Debtor and the creditor, creating the debt.
 - b) A secondary contract between the creditor and the surety, creating a liability of surety in case of debtor's fault.
 - c) An implied indemnity contract between the surety and the Principal Debtor whereby Principal Debtor is under an obligation to indemnify the surety; if the surety is made to pay or perform.
- 7) The communication of the surety with the creditor to enter into a contract of guarantee without the knowledge of the principal debtor will not constitute a contract of guarantee.
- 8) Out of 3 parties in a Contract of Guarantee, Surety must be competent to the contract. The Guarantee is still valid even Principal Debtor and Creditor is minor.

- b) No separate consideration is required for Surety. Anything done, or promise made for the benefit of the principal debtor is sufficient consideration to the surety for giving the guarantee⁹.

4) **Existence of a Liability:** There should be a liability, existing or future, enforceable at law¹⁰. Thus a guarantee given for a non-enforceable debt or obligation is not valid¹¹

5) **Consideration:**

- a) Consideration received by the Principal Debtor is sufficient for the Surety.
- b) It may not be necessary that it should result in some benefit to the Surety himself.
- c) It is sufficient if something is done or some promise is made for the benefit of the Principal Debtor
- d) Past consideration is not a valid consideration for Contract of Guarantee.

6) **No misrepresentation or concealment (section 142 and 143):** Contract of Surety/Guarantee should not be obtained by misrepresentation or concealment of a material fact.

7) **Writing not necessary (Section 126):** Contract of guarantee can be oral or written. It can be express or implied¹².

8) **Joining of other co-sureties (Section 144):** If a contract of guarantee provides that a creditor shall not act on it until another person has joined in it as co-surety then the contract of guarantee is not valid, if that other person does not join.

SIMILAR QUESTIONS:

1) A obtains housing loan from BIG Housing Ltd. B promises to pay BIG Housing Ltd in the event of A failing to repay. Is there a contract of guarantee? Will your answer be different in case the loan is taken from NATIONAL Bank.

A. Yes. Creditor can be any person including NATIONAL bank.

2) X and Y go into a car showroom where X says to the dealer to supply latest model of BMW to Y. If Y fails to pay, X will pay for it. Is there a contract of guarantee?

A. Yes. Because X promises to discharge the liability of Y in case of his defaults

3) B requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promise to deliver the goods. C argued that since he has not received any consideration from B, there is no contract of guarantee. He further said that a contract without consideration is void ab initio. You are required to state the following. Is C correct in his approach?

Will your answer be different, in case B pays to C an amount of Rs. 500 for giving guarantee, before the execution of contract?

A. The argument of C is not correct. In case of contract of Guarantee, credit given by Creditor to Principal Debtor based on the guarantee given by Surety is enough consideration for Surety (Sec.127)

There is no change in answer even if B pays Rs.500 to C (Of course it is also valid contract of guarantee)

4) A sell and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year, and promises that if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. Is this a sufficient consideration for C's promise.

A. Yes, A agrees to forbear to sue B for a year on the request of C is a sufficient consideration.

9) There are 3 contracts in contract of guarantee. Consideration is present in all contracts. Principal debtor is getting loan from Creditor and Surety is giving guarantee.

Contract 1 between Principal Debtor and Creditor: Principal Debtor is getting loan from creditor and creditor is getting loan and interest from Principal Debtor.

Contract 2 between Surety and Creditor: Anything which is done for the benefit of Principal debtor is consideration to surety and Creditor is getting additional security that in the event of breach of contract by Principal debtor, creditor can claim from surety.

Contract 3 between Surety and Principal Debtor: The promise of Principal Debtor to indemnify surety is consideration to Surety. Surety is undertaking to pay liability (which is detriment to surety) is consideration to Principal Debtor.

10) Though minor's debt is not enforceable by law against minor, yet the guarantee given for minor's debt is valid.

11) Guarantee to the time barred debt is not valid.

12) A is the mutual friend of B and C. One day B came to A for the want of necessities. A asked B to approach C for anything he desires. Meanwhile A told to C to arrange necessities for B. Here A did not have given any guarantee expressly. However there is responsibility on A to repay the loan in the event of B's failure to repay the money. There is implied contract of guarantee between A and C.

5) B requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promise to deliver the goods. Is this a sufficient consideration for C's promise

A. Yes. A's promise to deliver the goods to B on the guarantee of C is a valid consideration to C.

6) A gave a loan of Rs. 1,00,000 to B. C afterwards, without consideration, agrees to pay the loan in default of B. Is the agreement valid? Would your answer differ if at the time of C giving guarantee, A gave to B a new loan of Rs. 10,000 and C gave guarantee for the entire debt due by B to A.

A. No. The agreement is void since past consideration is not valid consideration in contract of guarantee.
Yes. The contract is valid. There is some fresh consideration moving from the creditor at the time of guarantee. Guarantee for Rs. 1,10,000 (old debt & new debt) is valid since consideration need not be adequate.

7) A, Minor has borrowed a sum of Rs.10,000 from B. C has guaranteed B that in the event of failure of A, he will repay to B. You are required to state the following.

- Is there a valid contract of guarantee?
- Will your answer be different, in case A is not a minor and C is minor?
- Will your answer be different, in case A & C are not minors but B is a minor.

A. The Principal Debtor need not be competent to contract. Even if Principal Debtor is incompetent to contract, the guarantee is valid. But, if surety is incompetent to contract, the guarantee is void.

- Yes there is a contract of Guarantee and it is valid.
- There is no valid contract of Guarantee
- Yes there is a contract of Guarantee and it is valid since a minor can be beneficiary in a contract.

8) C sells and delivers goods to P. Is contract of guarantee valid in each of the following alternative cases?

Case (a): If S afterwards agrees to pay for the goods in default of P.

Case (b): If S afterwards requests C to allow a credit for a period of 1 year to P and promises that if C does so, he will pay for the goods if P defaults. C agrees to allow as requested.

A. Decision and Reason:
Case (a): The agreement of guarantee is void because such agreement was without any consideration.
Case (b): The agreement of guarantee is valid because credit period allowed was a sufficient consideration for S's promise.

(IMMEDIATELY REFER PRACTICAL QUESTION: 1)

Q.No.4. Types of guarantee.

(C) (NEW SM, OLD SM)

GUARANTEE CAN BE CLASSIFIED AS UNDER:

- Retrospective Guarantee:** A guarantee given for an existing debt or obligation is called 'retrospective guarantee'. Of course, guarantee given for past debt is invalid. However, the same would be valid if some fresh consideration is moving from the creditor to the debtor at the time of guarantee. (for example, further advance made by creditor to debtor)
- Prospective Guarantee:** A guarantee given for a future debt or obligation is called prospective guarantee.
- Specific Guarantee:** This guarantee is for a specific or single transaction. It ends when the debt is discharged or promise is performed.
- Continuing Guarantee:** This guarantee is for a series of transactions. Liability extends till the revocation of guarantee.

Q.No.5. Write about specific guarantee and Continuing Guarantee?

(B) (NEW SM)

SPECIFIC GUARANTEE:

- A guarantee given to a single debt or specific transaction is called 'Specific' or 'Simple' guarantee or Ordinary guarantee¹³.

¹³⁾ Unlike a continuing guarantee, a specific guarantee can't be revoked. It comes to an end when the guaranteed debt is duly discharged or the promise is duly performed.

- 2) The specific guarantee comes to an end when -
 - a) The guaranteed debt is repaid or
 - b) The promise is duly performed.
- 3) Revocation is not possible

CONTINUING GUARANTEE [SEC.129]:

- 1) A guarantee which extends to a series of transactions¹⁴ is called a "continuing guarantee".
- 2) In the continuing guarantee, the liability of surety extends till the -
 - a) Performance or discharge of all the transactions entered into or
 - b) Revocation of guarantee.

(IMMEDIATELY REFER PRACTICAL QUESTION. 2, 3)

Q.No.6. When surety is discharged?

(C) (NEW SM, OLD SM)

A Surety is discharged from liability on a guarantee under the following circumstances:

- 1) By revocation of the Contract of Guarantee
- 2) By the conduct of the Creditor, or
- 3) By invalidation of the Contract of Guarantee.

Q.No.7. Point out the circumstances in which Surety is discharged from liability by revocation of continuous Guarantee?

(A) (NEW SM, OLD SM)

- 1) **EXPRESS REVOCATION (SEC 130):** The continuing guarantee may be revoked at any time by the Surety, as to future transactions by serving notice to the creditors.
NOTE: However, no revocation is possible,
 - a) Where a continuing relationship is established or
 - b) For the past transactions which have already taken place
- 2) **DEATH OF SURETY (SEC 131):** In the absence of any contract to the contrary, death of the surety operates as a revocation of continuing guarantee, as to the future transactions taking place after the death of surety.
NOTE: However, the surety's estate remains liable for the past transactions which have already taken place. *The position remains same even if notice of death is not served to the creditor.*
- 3) **BY NOVATION [SECTION 62]:** The surety under original contract is discharged if a fresh contract is entered into either between the same parties or between the other parties, the consideration being the mutual discharge of the old contract.
- 4) **A CONTINUING GUARANTEE MAY ALSO BE REVOKED UNDER THE FOLLOWING CIRCUMSTANCES:**
 - a) Variance in terms of contract
 - b) Loss of Security
 - c) Release or discharge of Principal Debtor
 - d) Arrangement with Principal Debtor

14) A guarantees payment to B, a tea-dealer, to the amount of \$ 100, for any tea he may from time to time supply to C. B supplies C with tea to above the value of \$ 100, and C pays B for it. Afterwards B supplies C with tea to the value of \$ 200. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of \$100.

On A's recommendation B, a wealthy landlord employs C as his estate manager. It was the duty of C to collect rent on 1st of every month from the tenant of B and remit the same to B before 5th of every month. A, guarantee this arrangement and promises to make good any default made by C. This is a contract of continuing guarantee.

SIMILAR QUESTIONS:

1) A, in consideration of B's discounting, at B's request, bills of exchange for C, guarantees to B, for twelve months, the due payment of all such bills to the extent of 50,000 rupees. B discounts bills for C to the extent of 20,000 rupees. Afterwards, at the end of three months, A revokes the guarantee. Is the revocation of guarantee valid? Is A discharged from liability of Principal Debtor?

A. Generally revocation of guarantee is invalid. However, a continuing guarantee can be revoked at any time only after giving proper notice to Creditor. This revocation discharges A from all liability to B for any subsequent discount. Of course A is liable to B for the 20,000 rupees, on default of C.

2) A guarantees to B, to the extent of 100,000 rupees, that C shall pay all the bills that B shall draw upon him. B draws upon C. C accepts the bill. A gives notice of revocation. C dishonors the bill at maturity. Is A liable to B

A. Revocation of specific guarantee is not allowed. Therefore A is liable upon his guarantee.

(IMMEDIATELY REFER PRACTICAL QUESTION: 5, 6, 7)

Q.No.8. State circumstances/conditions in which contract of guarantee can be treated as invalid/void?

(A) (NEW SM, OLD SM)

Following are the circumstances where a guarantee can be treated as invalid.

- 1) **GUARANTEE OBTAINED BY MISREPRESENTATION [SEC 142]:** Any guarantee obtained by misrepresentation made by a creditor, or with his knowledge and assent, relating to a material part of the transaction, is invalid.
- 2) **GUARANTEE OBTAINED BY CONCEALMENT OF FACTS [SEC 143]:** Any guarantee obtained by a creditor by means of keeping silence as to material circumstances to contract is invalid¹⁵.
- 3) **FAILURE OF CO-SURETY TO JOIN A SURETY CONTRACT [SEC 144]:** When a contract of guarantee provides that a creditor shall not act on it until another person has joined in it as co-surety, the guarantee is not valid if that person does not join.
- 4) **FAILURE OF CONSIDERATION:** When there is no consideration between the Principal Debtor and Creditor, the Surety is discharged.

(IMMEDIATELY REFER PRACTICAL QUESTION: 8)

Q.No.9. Point out the circumstances in which a surety is discharged from liability by the conduct of the creditor.

(A) (NEW SM, OLD SM, OLD PM, CMA D10-4M, M02 - 10M, M09 - 1M)

1) VARIANCE IN TERMS OF CONTRACT (SEC 133):

- a) Any variance made in the terms of contract between the Principal Debtor and the creditor, without surety's consent, discharges the surety as to transactions subsequent to the variance¹⁶
- b) However, the surety is not discharged in the following cases:
 - i) Variance is made with the consent of Surety.
 - ii) Variation which is not substantial or material, or which is beneficial to the Surety¹⁷.

2) RELEASE OR DISCHARGE OF PRINCIPAL DEBTOR (SEC 134): The surety is discharged by -

- a) Any contract between the creditor and the Principal Debtor, by which Principal Debtor is released, or
- b) Any act or omission of the creditor, the legal consequence of which is the discharge of the Principal Debtor.

15) B contracts to build a ship for C for a given sum, to be paid by installments as the work reaches certain stages. A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays to B the last two installments. A is discharged by this prepayment.

16) A guarantees C against the misconduct of B in an office to which B is appointed by C, and of which the duties are defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, B misconducts himself. A is discharged by the change from future liability under his guarantee, though the misconduct of B is in respect of a duty not affected by the later Act.

17) In M.S. Anirudhan v. Thomco's Bank, the surety guaranteed overdraft provided by the bank to the principal debtor only up to Rs. 25,000. Subsequently since the bank was willing to provide overdraft only up to Rs. 20,000, the principal debtor reduced the amount in the guarantee form to Rs. 20,000. On default by the principal debtor the court held the surety liable as the alteration was beneficial to him and it was not of a substantial nature.

There are certain exceptions to the above rule. These are given hereunder:

- i) A mere forbearance on the part of a creditor to sue the debtor or to enforce any other remedy against Principal Debtor would not discharge the surety in the absence of any specific provision.
- ii) Even where the claim is barred by limitation, surety is still responsible¹⁸ (Refer Pg. No. 2.20)

3) IMPAIRMENT OF SURETY'S REMEDY (SEC 139): Surety is discharged,

- a) If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act¹⁹ which the duty to the surety requires him to do, and
- b) The eventual remedy of the surety against the Principal Debtor is thereby impaired

4) COMPOUNDING WITH PRINCIPAL DEBTOR [SEC 135]:

Surety is discharged by any contract between creditor and Principal Debtor by way of which -

- a) Creditor makes a composition²⁰ with Principal Debtor or
- b) Creditor agrees to give time to Principal Debtor, or
- c) Creditor agrees not to sue the Principal Debtor.

But where the surety assents to such contract, then he is not discharged

HOWEVER, THE SURETY IS NOT DISCHARGED IN THE FOLLOWING CIRCUMSTANCES -

- 1) **Agreement made with third person to grant time to Principal Debtor [Sec 136]:** Where a contract to give time to the Principal Debtor is made by the creditor with a third person, and not with the Principal Debtor, the surety is not discharged.
- 2) **Creditor's forbearance to sue [Sec 137]:** In the absence of any contract to the contrary, mere forbearance on the part of the creditor to sue the Principal Debtor or to enforce any other remedy against him, does not discharge the surety.
- 3) **Release of one co-surety [Sec 138]:** When there are co-sureties, release of one of them by creditor does not discharge the others neither does it free the surety so released from his responsibilities to the other sureties

SIMILAR QUESTIONS:

- 1) P borrowed a sum of Rs. 50,000 from C for which S gave a guarantee to C. The contract was executed on a document. Later P changed his residential address. C modified the contract with respect to change of address of P without consent of S. Is S discharged from the contract of surety ship? Would your answer different if C also changed the interest rate from 8% to 10%?
- A. Change of address of P in a contract without consent of surety is not substantial or material variation. Thus, surety is not discharged from the contract of surety ship.
- Yes there is change in answer in the Second case, as rate of interest is increased without consent of surety is material variation. Thus, S gets discharged.
- 2) A, contracts with B for a fixed price to build a house for B within a stipulated time, B would supply necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C is discharged from his liability (NEW SM-TYK)
- A. The contract between A and B is Mutual and dependent. The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission for the creditor, the legal consequence of which is the discharge of the principal debtor. In the given case the B omits to supply the timber. Hence C is discharged from his liability.

18) Case law: *In Krishto Kishore vs. Radha Romun*,

Facts of the case: The plaintiff sued the surety & legal representatives of the Principal Debtor after knowing the fact of the death of the Principal Debtor to avoid the debt being barred by limitation.

Decision: The surety is still liable. Where it was held that omission of the creditor to sue within the period of limitation does not discharge the surety.

19) A puts M as apprentice to B, and gives a guarantee to B for M's fidelity. B promises on his part that he will, at least once a month, see that M make up the cash. B omits to see this done as promised, and M embezzles. A is not liable to B on his guarantee.

20) P purchased a Motor Bike from C under a hire-purchase agreement on guarantee of S for the due performance of the agreement. C for valuable consideration gives P further time for payment of one of the installments. Held, the giving of time to P discharged S from any further liability under the guarantee.

3) C agrees to appoint B as his clerk to sell goods at a yearly salary, upon A's becoming surety to C for B's duly accounting for moneys received by him as such clerk. Afterwards, without A's knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not by a fixed salary. Is surety liable to Contract of Guarantee subsequent to the change in terms of contract?

A. Change in terms of arrangement between A and B without consent of Surety A. A is not liable for subsequent misconduct of B.

4) C contracts to lend B Rs. 5,00,000 on the 1st March. A guarantees repayment. C pays the Rs. 5,00,000 to B on the 1st January. Is A liable under Contract of Guarantee?

A. A is discharged from his liability, as the contract has been varied, in as much as C might sue B for the money before the 1st March.

5) B contracts to build a ship for C for a given sum, to be paid by instalments as the work reaches certain stages. A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays to B the last two instalments. Is A liable to perform the remaining work?

A. No, A is not liable to perform the remaining work as A is discharged by this prepayment.

6) S, Y and C guarantees payment to Z for the supplies of Iron to G. G defaulted his payment to Z. Z releases Y to pay of his debt. Is Y released from his responsibilities to the other sureties?

A. No, because as per Sec-138 Release of one co-surety does not discharge others.—Where there are co-sureties, a release by the creditor of one of them does not discharge the others, neither does it free the surety so released from his responsibility to the other sureties.

(IMMEDIATELY REFER PRACTICAL QUESTION 9, 10, 11, 12, 13, 14)

Q.No.10. State the rights of a Surety against the Principal Debtor, Creditor? (B)

(NEW SM, OLD SM, OLD PM, N 99 - 5M)

After the performing of the promise or discharging of the liability of the Principal Debtor, surety acquires various rights against the parties.

1) RIGHTS AGAINST THE PRINCIPAL DEBTOR:

a) Rights of subrogation [Sec 140]:

- i) On payment of the guaranteed debt or performance of the guaranteed duty, the surety acquires all the rights with which the creditor had against the Principal Debtor.
- ii) This right is known as right of subrogation²¹. The surety steps into the shoes of the creditor.

b) Right to be Indemnified [Sec 145]:

- i) In every contract of guarantee there is an implied promise by the Principal Debtor to indemnify the surety.
- ii) The surety is entitled to recover from the Principal Debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully²².

2) RIGHT AGAINST THE CREDITOR:

a) Right to claim the creditor's securities [Sec 141]:

- i) A surety is entitled to the benefit of every security which the creditor has against the Principal Debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not;
- ii) If the creditor loses or parts with the security without the consent of the surety, the surety is discharged to the extent of the value of the security²³.

21) On payment of guaranteed debt or performance of the guaranteed duty, the surety may therefore, claim the securities (if any) held by the creditor and sue the principal debtor, or may claim dividend in insolvency of the debtor.

22) C lends B a sum of money, and A, at the request of B, accepts a bill of exchange drawn by B upon A to secure the amount. C, the holder of the bill, demands payment of it from A, and, on A's refusal to pay, sues him upon the bill. A, not having reasonable grounds for so doing, defends the suit, and has to pay the amount of the bill and costs. He can recover from B the amount of the bill, but not the sum paid for costs, as there was no real ground for defending the action.

23) C, a creditor, whose advance to B is secured by a decree, receives also a guarantee for that advance from A. C afterwards takes B's goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged.

A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives the up the further security, A is not discharged.

- b) **Right to claim Set off:** The surety has the right to claim set off or counter claim, if any, which the Principal Debtor had against the creditors in case the creditors sue him for payment of liability of Principal Debtor.
- c) **Right to share reduction:** The surety has the right to claim proportionate reduction in his liability if the principal debtor becomes insolvent.

SIMILAR QUESTION:

- 1) C advances to B, his tenant, 2,00,000 rupees on the guarantee of A. C has also a further security for the 2,00,000 rupees by a mortgage of B's furniture. C cancels the mortgage without consent of A. B becomes insolvent and C sues A on his guarantee. Comment? (N-19)
- A. A is discharged from liability to the amount of the value of the furniture.
- 2) P took a loan of Rs. 50,000 from C. S gave a guarantee for the said loan amount. Also C is liable to S for Rs. 25,000 in a separate contract between C and S. On due date, P failed to repay the loan amount. C sued S for recovery of Rs. 50,000 but S paid only Rs. 25,000. Can S do so?
- B. S can set off Rs. 25,000 which is due to him from C. However, S can claim total Rs. 50,000 from P.
- 3) A guarantees to C, to the extent of 2,00,000 rupees, payment for rice to be supplied by C to B. C supplies to B, rice amount of Rs. 1,00,000 rupees, but obtains from A a payment of the sum of 2,00,000 rupees in respect of the rice supplied. Can A recover Rs. 2,00,000 from B?
- A. A cannot recover from B more than the price of the rice actually supplied. However, A might recover from C the excess paid u/s 72 – “payment made under a mistake or coercion can be taken back.”

Q.No.11. State the rights of a Surety against Co-sureties (B) (New SM & OLD SM)

RIGHT OF CONTRIBUTION: When a debt is guaranteed by two or more sureties, they are called co-sureties. The co-sureties are liable to contribute, as agreed, towards the payment of the guaranteed debt. When one of the co-sureties makes payment to the creditor, he has a right to claim contribution from the other co-surety or co-sureties.

- 1) **Co-sureties liable to contribute equally (Sec 146):**
 - a) In the absence of any contract to the contrary, the co-sureties are liable to contribute equally.
 - b) The principle will apply even when the liability of co-sureties is joint or several, and whether under the same or different contracts and whether with or without the knowledge of each other.
- 2) **Liability of co-sureties bound in different sums (Sec 147):** Co-sureties bound in different sums, shall pay equally up to the limits of their respective obligations.
- 3) **Release of a co-surety:** Where there are co-sureties, release of one co-surety by the creditor does not discharge the others. Also the surety so released by the creditor is liable to other co-sureties.

(IMMEDIATELY REFER PRACTICAL QUESTION: 15, 16)

Q.No.12. Is liability of two sureties affected by mutual arrangements? (C) (NEW SM, OLD SM)

LIABILITY OF TWO SURETIES IS NOT AFFECTED BY MUTUAL ARRANGEMENTS [SEC 132]:

- 1) Where two persons contract with a third person to undertake a certain liability and
- 2) Such two persons also contract with each other that one of them shall be liable only on the default of the other, third person not being a party to such contract,
- 3) The liability of each of such two persons to the third person under the first contract is not affected by the existence of the second contract between those two persons, even though such third person may have been aware of its existence.

SIMILAR QUESTION:

- 1) Mr. D was in urgent need of money amounting to Rs. 5,00,000. He asked Mr. K for money. Mr. K lent the amount on the sureties of A, B and N. Later A, B and N entered into an agreement stating that, Mr A would be liable if Mr D defaults in repayment of loan to Mr. K. Does this agreement discharge B and N from their guarantee?
- A. Refer above Provision, B and N are not discharged as the contract among A, B and N does not affect the main guarantee contract.

2) A and B make a joint and several promissory note to C. A makes it, in fact, as surety for B, and C knows this at the time, when the note is made. The fact that A, to the knowledge of C, made the note as surety for B is not an answer to a suit by C against A upon the note.

Q.No.13. Explain the nature and extent of Surety's liability. (B)

(NEW SM, OLD SM, M 98, N 00, N 01 - 5M, M08 - 1M)

- 1) **Liability of Surety:** In the absence of contract to the contrary, the liability of the surety is co-extensive with that of the Principal Debtor. (Refer Note)
- 2) **Secondary Liability:** The liability of a surety arises only on default by the Principal Debtor.
- 3) Where a debtor cannot be held liable on account of any defect in the document, the liability of the surety also comes to an end.
- 4) Surety's liability continues even if the Principal Debtor has not been sued or is omitted from being sued because the liability of surety is separate in the contract of guarantee.
- 5) If the principal debt is illegal or unenforceable, the Principal Debtor as well as surety shall not be liable.
- 6) If the Principal Debtor is discharged by creditor's breach, the Surety shall also be discharged²⁴.

NOTE: The term "co-extensive with that of Principal Debtor" means that the surety is liable for what the Principal Debtor is liable.

SIMILAR QUESTIONS:

- 1) A has discounted a bill for Rs. 50,000 at DIGITAL BANK given by B. C has guaranteed the payment for A to DIGITAL BANK. The bill is dishonoured by B on the due date. DIGITAL BANK charged an amount of Rs. 5,000 towards interest. On due date, A failed to pay the amount to DIGITAL BANK. C claimed that he is liable only for amount received by A. You are required to
 - a) State whether C's contention is correct?
 - b) To what extent C is held liable?

A. Provision: Refer Section 128.

Conclusion: No. C is liable not only for the amount of the bill but also for any interest and charges which may have become due on it. Total Liability of C (surety) is Rs. 55,000/- (Rs. 50,000 + Rs. 5,000).

SECTION 2: DIFFERENCES – FOR STUDENTS SELF STUDY

Q.No.14. Contract of Indemnity Vs. Contract of Guarantee (A) (NEW SM -TYK, OLD SM, N17 - 4M)

(FOR STUDENT'S SELF STUDY)

DIFFERENCES	CONTRACT OF INDEMNITY	CONTRACT OF GUARANTEE
Meaning	It is a contract by which one party promises to save the other from loss caused to him	It is a contract to perform the promise or discharge the liability of third party in case of his default.
Parties	Indemnifier & indemnity holder.	Creditor, Principal Debtor & Surety.
Nature of liability	The liability of indemnifier is primary and independent.	The liability of a Surety is secondary and conditional.
Purpose	To reimburse the loss.	To provide security of a debt or performance of the promisor.
Time of Liability	Liability of the indemnifier arises only on the happening of a contingency.	Liability of Surety is secondary i.e., It arises only on default of Principal Debtor.

24) A contracts with B for a fixed price to build a house for B within a stipulated time on a condition that B will supply the necessary timber. C guarantees A's performance of the contract. This is a mutual and dependent contract between A and B. B omits to supply the timber. A gets discharged on B's breach of duty in supplying the timber. As a result C is also discharged from his surety ship.

Right to sue the third party	Indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour.	A Surety can proceed against Principal Debtor in his own right because he gets all the rights of a creditor after discharging the debts.
Competency to contract	All parties must be competent to contract.	The contract is valid even if a minor is Principal Debtor.
Number of Contracts	Only one (original and independent) contract between Indemnifier and Indemnified.	There are 3 contracts, between- <ul style="list-style-type: none"> • Creditor and Principal Debtor • Creditor and Surety • Surety and Principal Debtor
Time to Act	The indemnifier need not act at the request of indemnity holder	The surety acts at the request of principal debtor

SECTION 3: PRACTICAL QUESTIONS FOR CLASSROOM DISCUSSION

Q.No.1. X took a loan of Rs.10,000 from Y on 1st Jan 2013 and paid nothing on account of interest and principal. On 2nd Jan 2016, Z gave the guarantee to Y for the payment of Rs.10,000 due from X. Is this a valid guarantee? Would your answer be different if loan was taken on 02nd Jan 2016? **MTP - M19 (N)&N18(N)**

Provision: As per Section 126 of the Indian Contract act, 1872, a contract of Guarantee is valid if there is an existing liability and such liability or promise must be enforceable by law.

Analysis: In the present case, Z gave the guarantee to Y for the payment of Rs.10,000 due from X. Since the debt becomes a time barred, it is not enforceable by law.

Conclusion: This is not a Valid Contract of Guarantee because the primary liability between the X and Y is a time barred debt which is not enforceable by law.

In the second case the contract of guarantee is valid as debt between principal debtor and creditor is enforceable.

Q.No.2. A guarantees payment to a grocer to the amount of Rs. 2,000 for any grocery that is being purchased from time to time by his wife. Grocer supplies more than the value of Rs. 2000 which is paid by the A. Afterwards grocer again supplies the grocery to the value of Rs. 8,000. State the liability of A. **RTP N18 (O)**

Provision: As per Sec. 126 of the Indian contract Act, 1872, "Contract of Guarantee is a contract to perform the promise or discharge the liability of a third party in case of his default. Sec 129 of the Indian Contract Act, 1872, defines continuing guarantee as, "a guarantee which extends to a series of transactions". The liability of the surety in such a guarantee continues until the performance or discharge of all the transactions entered into or the guarantee is withdrawn.

Analysis and Conclusion: In the present case, guarantee given by A was a continuing guarantee and thus he is accordingly liable to grocer to the extent of Rs.2,000.

Q.No.3. S guarantees payment to C for the price of four laptop sets to be sold by C to P and to be paid for in a month. C delivers the sets to P. P pays for them. Later on, C delivers three more sets to P. State the liability of S.

Provision: As per Sec. 126 of the Indian contract Act, 1872, "Contract of Guarantee is a contract to perform the promise or discharge the liability of a third party in case of his default. Sec 129 of the Indian Contract Act, 1872, defines Continuing guarantee as, A guarantee which extends to a series of transaction is called a continuing guarantee.

Analysis and Conclusion: In the present case, The Guarantee given by S is not a continuing guarantee but it is a specific guarantee. Therefore, S is not liable for the price of the three sets which are supplied later to P.

Q.No.4. S gives guarantee for the loans given by C to P. P owes Rs. 1,00,000 to C. P becomes insolvent and a dividend of 20 paise in a rupee is declared. Discuss the rights of C and S if

- S gives the guarantee for the payment of the loan of Rs. 60,000
- S gives the guarantee for the payment of the loan subject to a limit of Rs. 60,000.

Provisions: According to Sec 128 of the Indian Contract Act, 1872, in the absence of contract to the contrary, the liability of the surety is co-extensive with that of the Principal Debtor. The Guarantee may be given for a part of the entire debt or for the entire debt subject to a limit.

Analysis and Conclusion:

- If the Guarantee is only for a part of the entire debt:** C will recover Rs.60,000 from S (i.e., the full guaranteed amount) and Rs.8,000 (20% of the balance of Rs.40,000) from P's estate. S after making payment to C, will step into C's shoes and recover Rs12,000 (20% of Rs.60,000) from P's estate²⁵.
- If the guarantee is for the entire debt subject to a limit:** C will recover Rs.60,000 from S (i.e., up to the guaranteed limit) and Rs.20,000 (20% of the entire debt 1,00,000) from P's estate. He will, therefore, get Rs.80,000 in all. S will not get any dividend from P's estate till the full amount of Rs.1,00,000 is paid to C²⁶.

Q.No.5. Ravi becomes guarantor for Ashok for the amount which may be given to him by Nalin within six months. The maximum limit of the said amount is Rs 1 lakh. After two months Ravi withdraws his guarantee. Up to the time of revocation of guarantee, Nalin had given to Ashok Rs 20,000.

- Whether Ravi is discharged from his liabilities to Nalin for any subsequent loan.
- Whether Ravi is liable if Ashok fails to pay the amount of Rs 20,000 to Nalin?

(OLD PM, M06 - 5M, Similar: N15 - 5M, N17 - 5M; RTP M18(O))

Provisions: As per Sec 130 of the India Contract Act, 1872, The continuing guarantee may at any time be revoked by the surety as to future transactions by notice to the creditors. A specific guarantee can be revoked only if liability to principal debtor has not accrued.

Analysis and Conclusion: In the present case, Ravi is discharged from all the subsequent loans because it's a case of continuing guarantee.

Whereas in second case, Ravi is liable for payment of Rs.20,000 to Nalin because the transaction has already completed.

Q.No.6. 'A' stands surety for 'B' for any amount which 'C' may lend to B from time to time during the next three months subject to a maximum of Rs. 50,000. One month later, A revokes the guarantee, when C had lent to B Rs. 5,000. Referring to the provisions of the Indian Contract Act, 1872 decide whether 'A' is discharged from all the liabilities to 'C' for any subsequent loan. What would be your answer in case 'B' makes a default in paying back to 'C' the money already borrowed i.e. Rs. 5,000?

Provisions: The problem asked in the question is based on the provisions of the Indian Contract Act 1872, as contained in Sec 130 relating to the revocation of a continuing guarantee as to future transactions which can be done mainly in the following two ways:

- By Notice:** A continuing guarantee may at any time be revoked by the surety as to future transactions, by notice to the creditor.
- By death of surety:** The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions. (Sec 131). The liability of the surety for previous transactions however remains.

Conclusion: Thus, applying the above provisions in the given case, A is discharged from all the liabilities to C for any subsequent loan.

25) In the given case, Out of Rs. 1,00,000 debt, Rs. 60,000 is the guaranteed debt and Rs. 40,000 is unguaranteed debt. Surety is responsible for entire guaranteed debt. On payment of Rs. 60,000 by S, S becomes creditor for the amount paid i.e. Right of subrogation. So S is entitled to claim dividend on Rs. 60,000 from the assets of P

26) In the given case, entire debt of Rs. 1,00,000 is guaranteed debt but surety restricted his liability to the extent of Rs. 60,000. Surety gets right of subrogation only when the guaranteed debt is cleared. But in the present case the creditor C has recovered Rs. 20,000 from the estate of P and Rs. 60,000 from S which amounts to Rs. 80,000. The total debt was not cleared so, surety is not entitled for right of subrogation.

In the second case the answer would change i.e. A is liable to C for Rs. 5,000 on default of B since the loan was taken before the notice of revocation was given to C.

Q.No.7. Manoj guarantees for Ranjan, a retail textile merchant, for an amount of Rs 1,00,000, for which Sharma, the supplier may from time to time supply goods on credit basis to Ranjan during the next 3 months. After 1 month, Manoj revokes the guarantee, when Sharma had supplied goods on credit for Rs 40,000. Referring to the provisions of the Indian Contract Act, 1872, decide whether Manoj is discharged from all the liabilities to Sharma for any subsequent credit supply. What would be your answer in case Ranjan makes default in paying back Sharma for the goods already supplied on credit i.e. Rs 40,000? **(RTP-M19)**

Provisions: As per section 130 of the Indian Contract Act, 1872, a specific guarantee cannot be revoked by the surety if the liability has already accrued. A continuing guarantee may, at any time, be revoked by the surety, as to future transactions, by notice to the creditor, but the surety remains liable for transactions already entered into.

Analysis and Conclusion: As per the above provisions, liability of Manoj is discharged with relation to all subsequent credit supplies made by Sharma after revocation of guarantee, because it is a case of continuing guarantee.

However, liability of Manoj for previous transactions (before revocation) i.e. for Rs 40,000 remains. He is liable for payment of Rs 40,000 to Sharma because the transaction was already entered into before revocation of guarantee.

Q.No.8. Mayank engages Babloo as a clerk to collect money for him. But Babloo fails to account for some of his receipts, and Mayank in consequence calls upon him to furnish security for his duly accounting. Amrit gives his guarantee for Babloo's duly accounting. Mayank does not acquaint Amrit with Babloo's previous conduct. Babloo afterwards makes default. Decide in the light of the provisions of the Contract Act, 1872, whether the guarantee is valid. **(MTP-M18)(N)**

Provisions: According to Sec 143 of the Indian Contract Act, 1872, any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

Analysis and Conclusion: In the present case, Mayank does not intimate Amrit about Babloo's previous conduct. Since guarantee is obtained by concealment of the material facts, the guarantee is invalid.

Q.No.9. A gives to C a continuing guarantee to the extent of Rs.5,000 for the vegetables to be supplied by C to B from time to time on credit. Afterwards, B became embarrassed, and without the knowledge of A, B and C contract that C shall continue to supply B with vegetables for ready money, and that the payments shall be applied to the then existing debts between B and C. Examining the provision of the Indian Contract Act, 1872, decide whether A is liable on his guarantee given to C. **(OLD PM, N08 - 5M, N17 - 4M, RTP-M19(N)&M18(O))**

Provisions and Analysis: Discharge of surety by variance in the terms of the contract. As per Sec.133 of the Indian Contract Act, 1872 any variance made without the surety's consent in the terms of the contract between the Principal Debtor and the creditor, discharges the surety with respect to the transactions subsequent to the variance.

The reason for such a discharge in the given case is that the surety agreed to be liable for a contract which is no more in existence and he is not liable on the altered contract because it is different from the contract made by him.

Conclusion:

- 1) In the given situation, A is discharged from all the subsequent arrangements because it's a case of continuing guarantee.
- 2) Further A is liable for payment of Rs. 5,000/- to C because the transaction has already completed.

Q.No.10. Mr. X, is employed as a cashier on a monthly salary of Rs 2,000 by ABC bank for a period of three years. Y gave surety for X's good conduct. After nine months, the financial position of the bank deteriorates. Then X agrees to accept a lower salary of Rs 1,500/- per month from Bank. Two months later, it was found that X has misappropriated cash since the time of his appointment. What is the liability of Y?

(NEW SM-TYK, OLD PM, RTP N14, N18(N) - 4M)

Provisions: Sec 133 of the Indian Contract Act, 1872

If the creditor makes any variance (i.e. change in terms) without the consent of Surety, then the surety is discharged as to the transactions subsequent to the change.

Analysis: In the instant case Y is liable as a surety for the loss suffered by the bank due to misappropriation of cash by X during the first nine months but not for misappropriations committed after the reduction in salary.

Conclusion: Hence, Mr. Y will be liable as a surety for the act of X before the change in the terms of contract i.e. during the first nine months. Variation in the terms of the contract (as to the reduction of salary) without consent of Mr. Y will discharge Mr. Y from all the liabilities towards the act of the Mr. X after such variation.

Q.No.11. S guaranteed overdraft provided by the bank to the P only up to Rs.25,000. Subsequently, since the bank was willing to provide overdraft only up to Rs.20,000, P reduced the overdraft amount (amount in the Guarantee) from Rs.25,000 to Rs.20,000. P defaulted in repayment of loan. The Bank sues S for the recovery of Guarantee amount. S refuses to pay the loan. Discuss the liability of S?

Provisions: Sec 133 of the Indian Contract Act, 1872 where there is any variance in the terms of contract between the Principal Debtor and creditor without surety's consent it would discharge the surety in respect of all transactions taking place subsequent to such variance. However, the surety is not discharged if variation in the contract is not substantial or material.

Analysis and Conclusion: In the Present case, the variation made between P and bank was beneficial to the S. Thus, S is held liable on default by P

Q.No.12. Explaining the provisions of the Indian Contract Act, 1872, answer the following:

- 1) A contracts with B for a fixed price to construct a house for B within a stipulated time. B would supply the necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C discharged from his liability?
- 2) C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with X to give time to B. Is A discharged from his liability?

- 1) According to Section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor. In the given case, B does not supply the necessary material as per the agreement.

Hence, C is discharged from his liability.

- 2) According to Section 136 of the Indian Contract Act, 1872, where a contract to give time to the principal debtor is made by the creditor with a third person and not with the principal debtor, the surety is not discharged.

In the given question the contract to give time to the principal debtor is made by the creditor with X who is a third person. X is not the principal debtor. Hence, A is not discharged.

Q.No.13. Mr. Ray made a contract with Mr. Basu to grow vegetables on Mr. Ray's land and to deliver to Mr. Basu at a fixed rate. Mr. Karmakar guarantees Mr. Ray's performance of this contract. Mr. Basu diverts stream of water, which is necessary for production thereby prevented Mr. Ray to grow vegetables. Mr. Ray fails to supply as per contract. Hence, Mr. Basu sues Mr. Karmakar (Guarantor), for non-performance. Advice.

Provision: According to Section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission for the creditor, the legal consequence of which is the discharge of the principal debtor.

Analysis and Conclusion: In the given case, it is the duty of Mr. Basu to supply water which is necessary for producing vegetables. Since Mr. Basu diverts steam of water, and thereby prevents Mr. Ray from growing the vegetables. Mr. Karmakar is no longer liable for his guarantee. Mr. Basu can not enforce this Surety contract.

Q.No.14. B owes C a debt guaranteed by A. C does not sue B for a year after the debt has become payable. In the meantime, B becomes insolvent. Is A discharged? Decide with reference to the provisions of the Indian Contract Act, 1872. **(Old PM, CMA D08 - 2M, RTP - N 14)**

Provisions: According to sec 137 of the Indian Contract Act, 1872 relating to discharge of surety. In the absence of any contract to the contrary, mere forbearance on the part of the creditor to sue the Principal Debtor or to enforce any other remedy against him, does not discharge the surety.

Analysis and Conclusion: In view of these provisions, A is not discharged from his liability as a surety.

Q.No.15. Mr. D was in urgent need of money amounting Rs 5,00,000. He asked Mr. K for the money. Mr. K lent the money on the sureties of A, B and N without any contract between them in case of default in repayment of money by D to K. D makes default in payment. B refused contribute. Examine whether B can escape liability? **(MTP-M19(N)) (M18(N) - 4M)**

Provisions and Analysis: As per section 146 of the Indian contract act, 1872, "when two or more persons are co-sureties for the same debt, or duty, either jointly or severally and whether under the same or different contracts and whether with or without the knowledge of each other, the co-sureties in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the Principal Debtor".

Conclusion: On the default of D in the payment, B cannot escape from his liability. All the three sureties A, B, and N are liable to pay equally, in the absence of any contract between them.

Q.No.16. A, B and C as sureties for D, enter into separate bonds of different amounts- A for Rs.10,000, B for Rs.20,000 and C for Rs.40,000. D makes default to the extent of (a) Rs.30,000 (b) Rs.40,000 (c) Rs.70,000. Discuss the liability of A, B, C?

Provisions: As per Section 147 of the Indian contract act, 1872, where the co-sureties have agreed to guarantee to different sums, the co-sureties are liable to contribute equally subject to the maximum amount guaranteed by each one. They are not liable in proportion to the amount guaranteed by them.

Analysis and Conclusion:

Case (a):

	A's Liability	B's Liability	C's Liability
i. Equal share in default (Rs 30,000 / 3)	10,000	10,000	10,000
ii. Maximum amount Guaranteed	10,000	20,000	40,000
iii. Actual Liability (Least of (i) & (ii))	10,000	10,000	10,000

Case (b):

	A's Liability	B's Liability	C's Liability
i) Equal share in default(Rs40,000/3)	13,333	13,333	13,334
ii) Maximum amount guaranteed	10,000	20,000	40,000
iii) Actual Liability of A (Least of (i) & (ii))	10,000	-	-
iv) Equal share in remaining default to be shared by remaining co-sureties (Rs. 40,000 - Rs 10,000/2)	-	15,000	15,000
v) Actual Liability of B & C (Least of (ii) & (iv))	-	15,000	15,000

Case (c):

	A's Liability	B's Liability	C's Liability
i) Equal share in default (Rs70,000/3)	26,666	26,667	26,667
ii) Maximum amount guaranteed	10,000	20,000	40,000
iii) Actual Liability of A & B (least of (i) & (ii))	10,000	20,000	-
iv) Remaining default to be shared by remaining Co-surety (Rs. 70,000 - Rs 10,000 - Rs. 20,000)	-	-	40,000
v) Actual liability of C (Least of (ii) & (iv))	-	-	40,000

SECTION 4: PRACTICAL QUESTIONS FOR STUDENTS SELF STUDY

Q.No.1. M advances to N Rs 5,000 on the guarantee of P. The loan carries interest at 10% per annum. Subsequently, N becomes financially embarrassed. On N's request, M reduces the interest to 6% per annum and does not sue N for one year after the loan becomes due. N becomes insolvent. Can M sue P? (NEW SM – TYK, OLD PM, N18 (O) - 4M)

PROVISION: As per Sec.133 of the Indian Contract Act, 1872 any variance made without the surety's consent in the terms of the contract between the Principal Debtor and the creditor, discharges the surety with respect to the transactions subsequent to the variance.

ANALYSIS AND CONCLUSION: If the creditor makes any change in the terms of his contract with the Principal Debtor without surety's consent then surety is discharged from his liability, no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety. M cannot sue P.

ALTERNATIVE ANSWER (In our View):

PROVISION: As per Sec.133 of the Indian Contract Act, 1872 any variance made without the surety's consent in the terms of the contract between the Principal Debtor and the creditor, discharges the surety with respect to the transactions subsequent to the variance. Variation which is not substantial or material or which is beneficial to the surety will not discharge him of his liability.

ANALYSIS AND CONCLUSION: In the given case, M reduces the interest to 6% per annum and does not sue N for one year after the loan becomes due. Though alteration was beneficial to Surety and not substantial but M extended time of one year without consent of Surety, the surety gets discharged.

Q.No.2. A stands as a Surety for the good conduct of B who is employed in a bank. B misappropriates some moneys but the bank excuses him without informing A of B's misconduct. B again misappropriates. Is A liable to the bank?

PROVISION: As per Sec. 139 of the Indian contract Act, 1872 Surety is discharged, If the creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which the duty to the surety requires him to do, **and** The eventual remedy of the surety against the Principal Debtor is thereby impaired

ANALYSIS AND CONCLUSION: It is the duty of the creditor not to do anything inconsistent with the rights of the surety. If the creditors act or omission deprives the surety of benefit of his remedy, the surety is discharged. Surety is discharged from his liability.

Q.No.3. C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with X to give time to B. Is A discharged from his liability? (OLD PM)

PROVISION: Applicable Sec.136 of the Indian Contract Act, 1872, Where a contract to give time to the Principal Debtor is made by the creditor with a third person, and not with the Principal Debtor, the surety is not discharged.

ANALYSIS AND CONCLUSION: In the given question the contract to give time to the Principal Debtor is made by the creditor with X who is a third person. X is not the Principal Debtor. A is not discharged.

Q.No.4. Neelesh guaranteed the honesty of Srinath in the employment of Gurudev. Srinath was found guilty of dishonesty in the course of the service, but Gurudev continued to employ him and did not inform Neelesh of what had occurred. Subsequently, Srinath committed further acts of dishonesty. Gurudev requires Neelesh to make good the loss caused by Srinath. Discuss the liability of Neelesh according to the Indian Contract Act, 1872.

N-19(O)

PROVISION: According to section 143 of the Indian Contract Act, 1872, any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

ANALYSIS: In the given question, Neelesh guarantees the honesty of Srinath who was already in the employment of Gurudev. While this guarantee was obtained, Gurudev kept silence about the previous act of dishonesty by Srinath and Gurudev continues to employ Srinath. Thus, in this case it seems that the guarantee of Srinath by Neelesh was obtained by concealment of material circumstances/ keeping silence on material circumstances.

Now, when Srinath again commits an act of dishonesty, Gurudev requires Neelesh to make good the loss caused by Srinath.

CONCLUSION: In the light of the facts of the case and the provisions of law, it appears that the guarantee was obtained by concealment of material circumstances/ keeping silence on material circumstances. Hence, the guarantee by Neelesh of Srinath will not be valid.

[NOTE: In the given question, it may also be presumed that firstly guarantee was given by Neelesh and then Srinath committed the first act of dishonesty. In this case section 137 of the Indian Contract Act, 1872 will be attracted.]

Q.No.5. S₁, S₂ and S₃ are sureties to C for a sum of Rs.4,000 lent to P. P makes a default to the extent of Rs.3,000. Discuss the liability of sureties in each of the following alternative cases:

Case (a): If there is no contract between sureties.

Case (b): If there is a contract between sureties that S₁ is responsible to the extent of one-quarter, S₂ to be responsible to the extent of one quarter and S₃ to be responsible to the extent of two quarters.

Case (c): If sureties enter into three separate security bonds of different amounts. S₁- Rs.700, S₂ - Rs.1,100, and S₃-Rs.1,200. (CMA D12 - 2M)

PROVISION: As per section 146 of the Indian contract act, 1872, In the absence of any contract to the contrary, the co-sureties are liable to contribute equally. The principle will apply even when the liability of co-sureties is joint or several, and whether under the same or different contracts and whether with or without the knowledge of each other.

As per Section 147 of the Indian contract act, 1872, where the co-sureties have agreed to guarantee to different sums, the co-sureties are liable to contribute equally subject to the maximum amount guaranteed by each one. They are not liable in proportion to the amount guaranteed by them.

ANALYSIS AND CONCLUSION: Co-sureties are liable to pay equally subject to the maximum amount guaranteed by each one.

Case (a): S₁, S₂ and S₃ are liable to pay Rs 1000 each because in the absence of any contract to the contrary, sureties are liable to contribute equally to the extent of default.

Case (b): S₁, S₂ and S₃ are liable to pay Rs.750, Rs.750 and Rs.1500, respectively, because co-sureties are liable to contribute according to the terms of contract.

Case (c): S₁ is liable to pay Rs.700 (being least of one third of Rs.3,000 and Rs.700), S₂ is liable to pay Rs.1,100 (being least of one half of Rs.2,300 and Rs.1,100) and S₃ is liable to pay Rs.1,200 (being least of Rs.1,200 and Rs.1,200).

Q.No.6. Star gives to sun a continuing guarantee to the extent of Rs. 15,000 for the groceries to be supplied by sun to moon from time to time on credit. Later, Moon became embarrassed, and without knowledge of star, moon and sun contract that sun shall continue to supply him with groceries for ready money, and that the payment shall be applied to the then existing debts between moon and sun.

Examine the provision of the Indian Contract Act, 1872, decide whether star is liable on his guarantee given to sun?

PROVISION: Sec 133 of the Indian Contract Act, 1872 where there is any variance in the terms of contract between the Principal Debtor and creditor without surety's consent it would discharge the surety in respect of all transactions taking place subsequent to such variance. However, the surety is not discharged if variation in the contract is not substantial or material.

ANALYSIS AND CONCLUSION: In this case star is not liable on his guarantee for any goods supplied after this new arrangement. Where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

Q.No.7. C agreed to sell a color TV set to P under a hire purchase agreement on guarantee of S and a pledge of P's furniture. The terms were:

Hire purchase price: 24000, Payable in 12 monthly installments, ownership to be transferred on the payment of last installment.

State whether S is discharged in each of the alternative cases.

- If after 7 months, P stopped paying the installments. C sued P for the payment of arrears and P then gave a notice revoking his guarantee for the remaining ones.
- If after 7 months, S died
- If C, without the knowledge of S agreed to increase the number of installments from 12 to 24 of Rs. 1,000 each
- If C terminated this agreement and entered into fresh contract with P taking a security bond from Z
- If C without the knowledge of S allowed P further time for payment of one of the installments.
- If C did not sue for a year after the debt has become payable
- If C without the knowledge of S transferred the ownership before the payment of last installment.
- If, on the installments being in arrears for 3 months, C terminated the contract and seized the goods.
- If C without the knowledge of S, canceled the pledge. P became insolvent and C sued S for his guarantee.

CASE	DECISION	REASON
a)	S is not discharged from his liability	S could not revoke his guarantee for the remaining months because the hire-purchase agreement was an entire indivisible transaction and could not be classified as a series of transaction. In other words, this contract was a contract of specific guarantee and not of continuing guarantee (Section 130)
b)	S's estate is liable	Death operates as a revocation liable of the continuing guarantee and not of a specific guarantee (Section 131)
c)	S is discharged from his liability	The terms of the contract have been varied without the surety's consent (Section 133)
d)	S is discharged from his liability	The original agreement has been terminated by C (Section 134)
e)	S is discharged from his liability	The creditor has given further time to the principal debtor without the surety's consent (Section 135)
f)	S is not discharged from his liability	Mere forbearance on the part of the creditor to sue the principal debtor does not discharge the surety (Section 137)
g)	S is discharged from his liability	The creditor has transferred the ownership before the payment of the last installments (Section 139)

h)	S is discharged from his liability	The creditor has terminated the agreement and seized the goods (Section 139)
i)	S is discharged from liability to the extent of the value of furniture	The creditor has cancelled the pledge (Section 141)

Q.No.8. A becomes surety to C for B's Conduct as manager in C's Bank. Afterwards, B and C contract, without A's Consent, that B's Salary shall be raised, and that he shall become liable for one fourth of the losses and overdrafts. B allows a customer to overdraw, and the bank loses a sum of money. Is A liable for this?

PROVISION: As per Sec 133 of the Indian Contract Act, 1872, if there is any variance in the terms of contract between the Principal Debtor and creditor without surety's consent it would discharge the surety in respect of all transactions taking place subsequent to such variance. However, the surety is not discharged if variation in the contract is not substantial or material.

ANALYSIS AND CONCLUSION: In this case, A is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss. If there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

Q.No.9. Mr. Chintu was appointed as Site Manager of ABC Constructions Company on a two years contract at a monthly salary of Rs 50,000. Mr. Ganesh gave a surety in respect of Mr. Chintu's conduct. After six months the company was not in position to pay Rs 50,000 to Mr. Chintu because of financial constraints. Chintu agreed for a lower salary of Rs 30,000 from the company. This was not communicated to Mr. Ganesh. Three months afterwards it was discovered that Chintu had been doing fraud since the time of his appointment. What is the liability of Mr. Ganesh during the whole duration of Chintu's Appointment? (RTP N19)

PROVISION: As per the provisions of Sec 133 of the Indian Contract Act, 1872 where there is any variance in the terms of contract between the Principal Debtor and creditor without surety's consent it would discharge the surety in respect of all transactions taking place subsequent to such variance. However, the surety is not discharged if variation in the contract is not substantial or material.

ANALYSIS: In the instant case, Mr. Ganesh is liable as a surety for the loss suffered by ABC Constructions company due to misappropriation of cash by Mr. Chintu during the first six months but not for misappropriations committed after the reduction in salary.

CONCLUSION: Hence, Mr. Ganesh, will be liable as a surety for the act of Mr. Chintu before the change in the terms of the contract i.e., during the first six months. Variation in the terms of the contract (as to the reduction of salary) without consent of Mr. Ganesh, will discharge Mr. Ganesh from all the liabilities towards the act of the Mr. Chintu after such variation.

Q.No.10. B is indebted to C, and A is surety for the debt. C demands payment from A, and on his refusal sues him for the amount. A defends the suit, having reasonable grounds for doing so, but he is compelled to pay the amount of debt with cost. Advice A.

PROVISION: As per Sec 145 of the Indian Contract Act, 1872, In every contract of guarantee there is an implied promise by the Principal Debtor to indemnify the surety. The surety is entitled to recover from the Principal Debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully.

ANALYSIS AND CONCLUSION: In this case, A can recover from B the amount paid by him for costs, as well as the principal debt. In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety.

SECTION 5: THINGS TO REMEMBER

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SECTION 6: TEST YOUR KNOWLEDGE

- 1) Mr. A puts 'M' as the cashier under Mr.B and agrees to stand as surety provided 'B' checks the cash every month. 'M' embezzles cash. According to the Indian Contract Act, 1872? **Hint: 'A' is not responsible, if B failed to verify the cash every month.**
- 2) "A" executed a guarantee in favour of State Bank of India as security for a loan to "B". Later "A" contended that the guarantee was not enforceable, as it was not supported by consideration, as he was not paid guarantee commission. Is A's stand correct in law? **[Hint Ans: A's stand is not correct)**
- 3) A, in consideration that B will employ C in collecting the rents of B's zamindari, promises B to be responsible, to the amount of Rs. 5,000 rupees, for due collection and payment by C of those rents. What is the nature of the Contract? **Hint: Continuing guarantee.**

4) X was entitled to an Income Tax Refund which was sent by post by the Income Tax Department. However, the Refund Cheque was lost in postal transit. X approached the Income Tax Authorities, who required him to provide an indemnity for issuing the refund. What is the nature of the Contract? **Hint: Indemnity**

5) D, a dealer, supplies certain goods to F in separate lots regularly. Z guarantees payment by F up to Rs 45,000 for goods supplied from time to time. Can a guarantee by Z be revoked? **Hint: Yes**

6) A Farmer contracted to sell grains to a Merchant, to be grown on his land. S guarantees performance by farmer. The Merchant later divert the stream of water necessary for irrigation of Farmer's land. As a result, the crop could not be grown. Is S liable for the guarantee? **Hint: No**

THE END

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