

**2. INDEMNITY AND GUARANTEE****QUESTION - WISE ANALYSIS OF PREVIOUS EXAMINATIONS**

No.	M-09	N-09	M-10	N-10	M-11 TO N-13	M- 14	N-14	M-15	N-15	M-16	N-16	M-17	N-17	M-18 (OLD)	M-18 (NEW)	N-18 (OLD)	N-18 (NEW)
THEORY QUESTIONS																	
T1	-	1	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T2	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T3	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T6	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T7	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T8	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T9	1	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T10	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T12	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T13	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
T14	-	-	-	-	-	-	-	-	-	-	-	-	4	-	-	-	-
PRACTICAL QUESTIONS FOR CLASS ROOM DISCUSSION																	
P1	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P2	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P3	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P5	-	-	-	-	-	-	-	-	-	-	-	-	5	-	-	-	-
P6	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P7	-	-	-	-	-	8	-	-	-	-	-	-	-	-	-	-	-
P8	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P9	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P10	-	-	-	-	-	-	-	-	-	-	-	-	4	-	-	-	-
P11	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	4
P12	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P13	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P14	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P15	-	-	-	-	-	-	-	-	-	-	-	-	-	4	-	-	-
P16	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
PRACTICAL QUESTIONS FOR STUDENTS SELF PRACTICE																	
P1	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P2	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P3	-	-	-	-	-	-	-	-	-	-	-	-	-	-	4	-	-
P4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P6	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
P7	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

*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:** <sup>1</sup>

a) As per Section 124 of the Indian Contract Act, 1872, a contract by which one party promises to save the other from loss caused to him

- by the conduct of the promisor himself or
- by the conduct of any other person

is called "Contract of Indemnity".

b) Contract of Indemnity is a form of contingent contract.

**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.

### **PARTIES:**

a) **Indemnifier:** The party who promises to save the other party from loss is known as 'Indemnifier'. *In the above case A is the Indemnifier*

b) **Indemnified:** The party who is promised to be saved against the loss is known as 'indemnified' <sup>2</sup>. *In the above case Railway company is the Indemnified or Indemnity holder*

### **FEATURES OF INDEMNITY CONTRACTS:**

a) **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.*

b) **Contingent contract:** The contract of indemnity assures to indemnify the loss. So, its performance is contingent upon incurrence of such loss by the indemnity holder.

c) **Express or Implied:** A contract of indemnity may be expressed or implied from the circumstances of each case.

### **SIMILAR QUESTION:**

1. The contract of insurance is not fully covered under the contract of indemnity. Comment.

A. **ICAI View:** Statement is correct. Contract of Indemnity includes loss occurred due to act of Promisor or some other person but it does not include loss occurred due to act of god. Whereas contract of Insurance covers loss occurred due to act of god also.

**Alternate view:** The Contract of Insurance<sup>3</sup> is indeed a contract of Indemnity. As the following is noticed in both the contracts:

- i) Both are Contingent on happening of an event.
- ii) Both are special contracts, but the general principles apply to both.
- iii) A promise to compensate is common.
- iv) Consideration is present in both the cases.

<sup>1</sup> Dictionary meaning of the word 'Indemnify' is 'to compensate'.

When a person assures the other to compensate the probable cost or loss, a contract of indemnity occurs

<sup>2</sup> Analysis: However, the definition of indemnity restricts the scope of contracts of indemnity as much as it covers only the loss caused:

i) By the conduct of the promisor himself, or

ii) By the conduct of any other person.

Thus, loss caused by the conduct of the promisee, or accident, or an act of God is not covered.

<sup>3</sup> Only General Insurance contracts are covered. Life Insurance contracts are not covered under contract of Indemnity as the loss happening to policy holder is loss of life which cannot be indemnified.

2. 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 as per Sec 124 is strictly interpreted, it would not cover the cases of loss caused by the events or accidents which do not depend upon the conduct of the promisor or any other person. In other words, contracts of insurance would be outside the purview of the Contract of Indemnity.

As per English law, a contract of Indemnity is defined as "a promise to save another from loss caused as a result of a transaction entered into at the instance of the promisor." This definition covers a promise to make good the loss arising from any cause (including act of god) whatsoever.

Thus, Indian courts follow the English law in respect of contract of indemnity which covers the contract of insurance also.

**Q.No.2. What are the rights of indemnity-holder when sued? (B)**

(NEW SM, 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):

- a) **Damages in Suit:** All damages which he may be compelled to pay in any suit in respect of matter covered under the contract.
- b) **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
- c) **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.
- d) **Sue for Specific performance:** If the indemnity holder had incurred an absolute liability, he becomes entitled to ask the indemnifier to indemnify him.

**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 QUESTION:**

1. 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. Refer above answer. (Ram is entitled to recover the compensation from Raj).

**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:** A, advances a loan of Rs. 5,000 to B and C promises to A that if B does not repay the loan, C will do so. This is a Contract of Guarantee.

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

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

### **ESSENTIALS OF A VALID GUARANTEE:**

- Tripartite Agreement:** A contract of guarantee is a tripartite agreement between the Principal Debtor, Creditor and Surety<sup>4</sup>.
- Concurrence:** A contract of Guarantee requires the concurrence (consent) of all the 3 parties to it viz. Principal Debtor, Creditor and Surety.
- 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:
  - 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.
  - Surety need not be benefited. Consideration received by the Principal Debtor is a sufficient consideration to the Surety for giving the guarantee.
- Existence of a Liability:** There should be an existing liability. Such liability or promise must be enforceable by law<sup>5</sup>.
- Consideration:**
  - Consideration received by the Principal Debtor is sufficient for the Surety.
  - It is not required that it must necessarily result in some benefit to the Surety himself.
  - It is sufficient if something is done or some promise is made for the benefit of the Principal Debtor<sup>6</sup>.
  - Past consideration is not a valid consideration for Contract of Guarantee<sup>7</sup>.
- Guarantee should not be obtained by misrepresentation or concealment of a material fact.
- Contract of guarantee can be oral or written. It can be express or implied<sup>8</sup>.
- Joining of other co-sureties:** 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.

**(IMMEDIATELY REFER PRACTICAL QUESTION CRD 1, SELF PRACTICE 1, 2)**

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<sup>4</sup> From the above definition, it is clear that in a contract of guarantee, there are three contracts

i) A principal contract between the Principal Debtor and the creditor, creating the debt.  
ii) A secondary contract between the creditor and the surety, creating a liability of surety in case of debtor's fault.  
iii) An implied 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.

<sup>5</sup> Though minor's debt is not enforceable by law, yet the guarantee given for minor's debt is valid.

<sup>6</sup> Ex: A sells 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. This is a sufficient consideration.

<sup>7</sup> Ex: A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

<sup>8</sup> X, an auctioneer, sold certain goods on the instructions of Y. Later on, it is discovered that the goods belonged to Z and not to Y. Z recovered damages from X for selling his goods. Here, X is entitled to recover the compensation from Y because there is an implied promise to compensate the auctioneer for any loss which he may suffer on the defective title of goods sold by auction.

## Q.No.4. Types of guarantee. (C)

(NEW SM, OLD SM)

**TYPES OF GUARANTEE:**

Guarantee can be classified as under:

- 1. 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<sup>9</sup>. (for example further advance made by creditor to debtor)
- 2. Prospective Guarantee:** A guarantee given for a future debt or obligation is called prospective guarantee.
- 3. Specific Guarantee:** This guarantee is for a specific or single transaction. It ends when the debt is discharged or promise is performed
- 4. 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, M 98, M 99, M 01 - 5M)

**SPECIFIC GUARANTEE:**

1. A guarantee given to a single debt or specific transaction is called 'Specific' or 'Simple' guarantee or Ordinary guarantee.
2. The specific guarantee comes to an end when -
  - a) the guaranteed debt is repaid or
  - b) the promise is duly performed.<sup>10</sup>

**CONTINUING GUARANTEE [SEC.129]:**

1. A guarantee which extends to a series of transactions 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 CRD. 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:

- a) By revocation of the Contract of Guarantee
- b) By the conduct of the Creditor, or
- c) By invalidation of the Contract of Guarantee.

<sup>9</sup> Ex: 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. This is a sufficient consideration.

<sup>10</sup> Example: X gave his godown to Y on a lease for 10 years on a lease rent of Rs.12,000 p.a. Z guaranteed that Y would fulfill his obligations. This is a contract of specific guarantee because the lease for 10 years is entirely an indivisible transaction and cannot be classified as a series of distinct transactions.

**Q.No.7. Point out the circumstances in which Surety is discharged from liability by revocation of continuous Guarantee? (A)**  
 (NEW SM, OLD SM)

- 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,
  - Where a continuing relationship is established<sup>11</sup> or
  - For the past transactions which have already taken place<sup>12</sup>.
- 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. Notice of death need not be served to the creditor.
- A continuing guarantee may also be revoked under the following circumstances:
  - Variance in terms of contract
  - Loss of Security
  - Release or discharge of Principal Debtor
  - Arrangement with Principal Debtor

**(IMMEDIATELY REFER PRACTICAL QUESTION CRD 5, 6)**

**Q.No.8. State circumstances in which contract of guarantee can be treated as invalid? (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.

**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 invalid<sup>13</sup>.

**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 CRD 7, 8, 9)**

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<sup>11</sup> Example: 'A' becomes surety of 'C' for B's conduct as manager in C's bank and 'B' is appointed on the faith of this guarantee, 'A' is precluded from annulling the guarantee so long as B acts as manager in C's bank.

<sup>12</sup> Example: A, in consideration of B's discounting, at A'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.

This revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for the 20,000 rupees, on default of C.

<sup>13</sup> Example: A engages B as a clerk to collect money for him, B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid.

**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 variance<sup>14</sup>.
- 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 Surety.

**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.

*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 would not discharge the surety in the absence of any specific provision.*
- ii) *Even where the claim is barred by limitation, surety is still responsible<sup>i</sup> (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 act 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<sup>15</sup>.

**4. Compounding with Principal Debtor [Sec 135]:**

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

- Creditor makes a composition with Principal Debtor or
- Creditor agrees to give time to Principal Debtor, or
- 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 -**

- a) **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.
- b) **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<sup>16</sup>.
- c) **Release of one co-surety [Sec 138]:** When there are co-sureties, release of one of them by creditor does not discharge the other co-sureties

<sup>14</sup> Example: A becomes surety to C for B's conduct as a 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 on overdrafts. B allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss.

<sup>15</sup> Example: 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. A is discharged by this prepayment.

<sup>16</sup> Example: B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. A is not discharged from his suretyship.

**SIMILAR QUESTIONS:**

1. 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? (CA N06) (OLD PM)
  - A. 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.
2. A, contracts with B for a fixed price to build a house for B within a stipulated time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber. Discuss the liability of C?
  - A. C is discharged from his surety ship.

**(IMMEDIATELY REFER PRACTICAL QUESTION CRD 10, 11, 12, 13, 14,  
SELF PRACTISE 3, 4, 5, 6)**

**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.

Rights of a surety may be classified as under:

1. Rights against the Principal Debtor;
2. Rights against the creditor;
3. Rights against co-sureties.

**1. 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 subrogation. 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 wrongfully<sup>17</sup>.

**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, irrespective of 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 security.

**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.

<sup>17</sup> Example 1: 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.

**SIMILAR QUESTION:**

1. 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 is compelled to pay the amount of the debt with costs. Discuss the Rights of A against B?
- A. Refer Rights of Surety against Principal Debtor (He can recover from B the amount paid by him for costs, as well as the principal debt).

**Q.No.11. State the rights of a Surety against the Co-sureties (B)**

(New &amp; 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.

**a) Co-sureties liable to contribute equally (Sec 146):**

- 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.

**b) 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<sup>18</sup>.**c) 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 CRD 15, 16, SELF PRACTICE 7)****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.

**Example:** 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.

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<sup>18</sup> Example 1 : A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 4,00,000 rupees; A is liable to pay 1,00,000 rupees, and B and C 1,50,000 rupees each.

Example 2 : A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 7,00,000 rupees. A, B and C have to pay each the full penalty of his bond.

## 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)

- 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<sup>19</sup>. (Refer Note)
- Secondary Liability:** The liability of a surety arises only on default by the Principal Debtor.
- 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.
- 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.
- If the principal debt is illegal or unenforceable, the Principal Debtor as well as surety shall not be liable.
- If the Principal Debtor is discharged by creditor's breach, the Surety shall also be discharged.

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

**Example:** A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

## DIFFERENCES FOR STUDENTS SELF STUDY

## Q.No.14. Contract of Indemnity Vs. Contract of Guarantee (A)

(NEW SM, OLD SM, N17 - 4M)

DIFFERENCES	CONTRACT OF INDEMNITY	CONTRACT OF GUARANTEE
<b>Meaning</b>	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.
<b>Parties</b>	Indemnifier & indemnity holder.	Creditor, Principal Debtor & Surety.
<b>Nature of liability</b>	The liability of indemnifier is primary and independent.	The liability of a Surety is secondary and conditional.
<b>Purpose</b>	To reimburse the loss.	To provide security of a debt or performance of the promisor.
<b>Time of Liability</b>	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.
<b>Right to sue the third party</b>	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.

<sup>19</sup> Nature of Surety's liability can be summed up as

- Liability of surety is of secondary nature as he is liable only on default of Principal Debtor.
- His liability arises immediately on the default by the Principal Debtor.
- The Creditor has a right to sue the surety directly without first proceeding against principal debtor.
- However, the surety may limit his liability by express provision in the contract of guarantee.
- Thus, the contract of guarantee may provide that the surety shall not be liable:

Beyond a fixed amount (where guarantee is fixed on amount) (or)

For any amount due after a fixed date (where guarantee is given with reference to time period may be fixed during, which the guarantee shall remain effective)

Eligible Parties	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"> <li>• Creditor and Principal Debtor</li> <li>• Creditor and Surety</li> <li>• Surety and Principal Debtor</li> </ul>
Time to Act	It is not necessary for the Indemnifier to act at the request of the Indemnified	It is necessary that the Surety should give the guarantee at the request of the Principal Debtor

### PRACTICAL QUESTIONS

**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? (B)

**Facts of the case:** 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.

**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 debt, 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.

**Q.No.2.** A guarantees payment to a grocer to the amount of Rs. 2,000 for any grocery that is being purchased 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. (B)

**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.2000.

**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. (B)

**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".

**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 to 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. (C)

**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 (1/5<sup>th</sup> 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 (1/5<sup>th</sup> of Rs.60,000) from P's estate.

- 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 (1/5<sup>th</sup> 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 C.

**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. (A)

- 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)

**Provisions:** As per Sec 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:** 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? (A)

**Facts of the case:** '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.

**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.

2. **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.

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.** 'A', 'B' and 'C' are partners in a firm. They jointly promise to pay Rs 1,50,000 to 'P'. C became insolvent and his private assets are sufficient to pay only 1/5 of his share of debts. A is compelled to pay the whole amount to P. Examining the provisions of the Indian Contract Act, 1872, decide the extent to which A can recover the amount from B. (B) (MTP M16, M14 - 8M)

**Provisions:** When two or more persons make a joint promise, the promisee may in the absence of express agreement to the contrary, compel anyone or more of such joint promisors to perform the whole of the promise.

In such a situation the performing promisor can enforce contribution from other joint promisors (Sec 143 of the Indian Contract Act). If anyone or more joint promisors make default in such contribution, the remaining joint promisors must bear the loss arising from such default in equal share.

**Analysis and Conclusion:** In the present case, A is entitled to receive (a) from C's assets - Rs,10,000 (1/5th of Rs 50,000) and (Rs 50,000 is the amount to be contributed by C being 1/3rd of Rs 1,50,000), (b) from B - Rs 70,000 (Rs 50,000 being his own share + 1/2 (50,000-10,000) i.e. Rs 20,000 being one half share of total loss of Rs 40,000 due to C's insolvency). A can recover Rs 70,000 from B.

**Q.No.8.** Examine what is the legal position, as to the following:

Ravi, Nalin and Ashok jointly borrowed Rs 50,000 from Ajay. The whole amount was repaid to Ajay by Nalin. Decide in the light of the Indian Contract Act, 1872 whether:

- a) Nalin can recover the contribution from Ravi and Ashok,
- b) Legal representatives of Ravi are liable in case of death of Ravi,
- c) Nalin can recover the contribution from the assets, in case Ashok becomes insolvent. (A)

**Provisions:** Sec 142 of the Indian Contract Act, 1872 requires that when two or more persons have made a joint promise, then, unless a contrary intention appears from the contract, all such persons jointly must fulfill the promise. In the event of the death of any of them, his representative jointly with the survivors and in case of the death of all promisors, the representatives of all jointly must fulfill the promise.

Sec 143 allows the promisee to seek performance from any of the joint promisors. The liability of the joint promisors has thus been made not only joint but "joint and several". Sec 43 provides that in the absence of express agreement to the contrary, the promisee may compel any one or more of the joint promisors to perform the whole of the promise.

Sec 143 deals with the contribution among joint promisors, the promisors may compel every joint promisor to contribute equally to the performance of the promise (unless a contrary intention appears from the contract). If any one of the joint promisors makes default in such contribution the remaining joint promisors must bear the loss arising from such default in equal shares.

**Analysis and Conclusion:** As per the provisions of above Sections,

- a) Nalin can recover the contribution from Ravi and Ashok because Ravi, Nalin and Ashok are joint promisors.
- b) Legal representative of Ravi are liable to pay the contribution to Nalin. However, a legal representative is liable only to the extent of property of the deceased received by him.
- c) Nalin also can recover the contribution from Ashok's assets.

**Q.No.9.** 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. (A) (MTP-M18)(New)

**Facts of the case:** Mayank engages Babloo as a clerk to collect money for him. Babloo fails to account for some of his receipts, and Mayank in consequence calls upon him to furnish security. Amrit gives his guarantee for Babloo's duly accounting but Mayank does not acquaint Amrit with Babloo's previous conduct. Babloo afterwards makes default. Is contract of Guarantee valid?

**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.10.** 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. (A) (OLD PM, N08 - 5M, N17 - 4M)

**Facts of the case:** Without the knowledge of A (surety) B and C contract that C shall continue to supply B with vegetables for ready money.

**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:** In the given problem all the above requirements are fulfilled. Therefore, A is not liable on his guarantee for the vegetables supplied after these new arrangements.

**Q.No.11.** 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? (A) (OLD PM, RTP N14, N18(N) - 4M)

**Facts of the Case:** 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.

**Provisions and Analysis:** 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.

**Conclusion:** 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.

**Q.No.12.** 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? (A)

**Facts of the Case:** 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 amount in the guarantee from Rs.25,000 to Rs.20,000.

**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.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. (A)

**Facts of the case:** 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.

**Provision:** Sec. 139 of the contract Act. - "if the creditor does any act which is inconsistent with the right of the surety, or omits to do any act which his duty to the surety requires him to do and the eventual remedy of the surety himself against the Principal Debtor is thereby impaired, the surety is discharged.

**Analysis and Conclusion:** In the present 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. (B) (Old PM, CMA D08 - 2M, RTP - N 14)

**Facts of the Case:** 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.

**Provisions and Analysis:** According to sec 137 of the Indian Contract Act, 1872 relating to discharge of surety. The Sec states that mere forbearance on the part of the creditor to sue the Principal Debtor and/or to enforce any other remedy against him would not, in the absence of any provision in the guarantee to the contrary, discharge the surety.

**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? (B) (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 3 separate bonds of different amounts- A for Rs.10,000, B for Rs.20,000 and C for Rs.40,000. If 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? (B)

**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	30,000
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	30,000
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))	-	-	30,000

## PRACTICAL QUESTIONS FOR STUDENTS SELF PRACTICE

**Q.No.1.** C sells and delivers goods to P. Is the agreement 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.

**Q.No.2.** C agrees to sell goods to P on the guarantee of S for payment of the price of goods in default of P. Is the agreement of guarantee valid in each of the following alternative cases: (CMA J12 - 2M)

**Case (a):** If C is a minor

**Case (b):** If S is a minor

**Case (c):** If P is a minor (A)

**Case (a):** The agreement of guarantee is void because the creditor is incompetent to contract.

**Case (b):** The agreement of guarantee is void because the Surety is incompetent to contract.

**Case (c):** The agreement of guarantee is valid because the incapability of Principal Debtor does not affect the validity of the contract of guarantee.

**Q.No.3.** 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? (A) (OLD PM, N18(O) - 4M)

Applicable Section 133 of The Indian Contract Act, 1872

**Hint:** M cannot sue P

**Reason:** 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.

**Q.No.4.** 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.

(A) (OLD PM)

Applicable Sec 134 of the Indian Contract Act, 1872

**Hint and Reason:** B omits to supply the timber. Hence C is discharged from his liability.

**Q.No.5.** 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? (A)

Applicable Sec. 139 of the contract Act.

Hint: Surety is discharged from his liability.

Reason: 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.

**Q.No.6.** 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? (B) (OLD PM)

Applicable Sec.136 of the Indian Contract Act, 1872

Hint: A is not discharged

Reason: 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.

**Q.No.7.** S<sub>1</sub>, S<sub>2</sub> and S<sub>3</sub> 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 S<sub>1</sub> is responsible to the extent of one-quarter, S<sub>2</sub> to be responsible to the extent of one quarter and S<sub>3</sub> to be responsible to the extent of two quarters.

**Case (c):** If sureties enter into three separate security bonds of different amounts. S<sub>1</sub>- Rs.700, S<sub>2</sub> - Rs.1,100, and S<sub>3</sub>-Rs.1,200. (B) (CMA D12 - 2M)

Sec. to which the given problem relates: Sec. 146 and 147.

Hint:

**Case (a):** S<sub>1</sub>, S<sub>2</sub> and S<sub>3</sub> 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):** S<sub>1</sub>, S<sub>2</sub> and S<sub>3</sub> 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):** S<sub>1</sub> is liable to pay Rs.700 (being least of one third of Rs.3,000 and Rs.700), S<sub>2</sub> is liable to pay Rs.1,100 (being least of one half of Rs.2,300 and Rs.1,100) and S<sub>3</sub> is liable to pay Rs.1,200 (being least of Rs.1,200 and Rs.1,200).

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

## **IMPORTANT SECTION NUMBERS**

CONCEPT	SEC NO.
“Contract of indemnity” defined	124
Rights of indemnity-holder when sued	125
“Contract of guarantee”, “surety”, “Principal Debtor” and “creditor”	126
Consideration for guarantee	127
Surety’s liability	128
“Continuing guarantee”	129
Revocation of continuing guarantee	130
Revocation of continuing guarantee by surety’s death	131
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### TEST YOUR KNOWLEDGE

1. X contracts to indemnify Y for the loss resulting out of litigation filed against him(Y) by Z Z obtains a court decree against Y Before paying to Z, Y sues X to get the promised amount Will B succeed? **Hint:** Yes, the Indemnity holder can demand specific performance from Indemnifier
2. D, a dealer, supplies certain goods to F in separate lots regularly Z guarantees payment by F upto Rs45,000 for goods supplied from time to time Can a Guarantee by Z be revoked?  
**Hint:** Refer Q No: 8
3. A farmer contracted to sell grains to merchant to be grown on his land S guarantees performance by farmer Merchants 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:** S is discharged from Guarantee contract
4. A obtains housing loan from LIC Housing and if B assures A's repayment of loan what is the nature of contract? **Hint:** Contract of Guarantee
5. If A becomes a surety to C for payment of rent by B under a lease and B and C contract, without the consent of 'A' that 'B' will pay higher rent, then what would be the liability of 'A' as a surety?  
**Hint:** A is discharged from the Guarantee contract
6. 'A' puts 'M' as the cashier under 'B' and agrees to stand as surety provided, 'B' checks the cash every month B does not check the cash every month 'M' embezzles the cash What is the liability of 'A' in this case? **Hint:** A (Surety) is not liable
7. On discharging the debt due by the Principal Debtor to the creditor what is the remedy available to the surety? **Hint:** The Surety gets discharged
8. A,B,C and D enter in a shop A says to the trader, "supply the goods required by B and if he does not pay, I will" C says to the trader, "Let D have the required goods I will see that you are paid" State the nature of the contract between A and B and that of between C and D.  
**Hint:** i Contract of Guarantee and ii Contract of Indemnity
9. X, an auctioneer, sold certain goods on the instructions of Y Later on, it is discovered that the goods belonged to Z and not to Y X recovered damages from X for selling his goods Can X recover the compensation from Y? **Hint:** X entitled to recover compensation from Y.
10. X asks Y to beat Z and promises to indemnify Y against the consequences Y beats Z and is fined Rs 1,000. Can Y claim Rs 1,000 from X? **Hint:** No, Y cannot claim amount from X.
11. S stands as surety for the good conduct of P who is employed in Bank on monthly salary of Rs 5,000 Discuss the liability of S in each of the following alternatives cases:

**Case (a):** two month after, S gave notice revoking his guarantee Five months after it is discovered that P has been continuously misappropriating Rs 1,000 per month

**Case (b):** two months after P's employment, S dies Five months after it is discovered that P has been continuously misappropriating Rs 1,000 per month

**Case (c):** Two month after P's employment, bank requested P to accept a salary of Rs 4,000 and P agrees to accept Five months after, it is discovered that P has been continuously misappropriating Rs 1,000 per month

**Case (d):** P misappropriates Rs 1,000 but the bank excuses him without informing S of P's misconduct P again misappropriates Rs 5,000 Bank asks S to pay Rs 5,000

**Hint: (a) & (b)** S is liable for misappropriation done by P in first 2 months **(c) & (d)** S is discharged from liability

12. Where there are co securities a release by the creditor of in of them does not discharge the others  
**Hint:** Yes, CO-Sureties are not discharged (M07)

13. In a contract of guarantee forbearance by the creditor to sue the Principal Debtor discharges the surety. **Hint:** No, The surety is not discharged (M08)

14. Any variation in terms of contract made between Principal Debtor and creditor without the consent of surety automatically discharges the liability of the surety **Hint:** Refer Q.No.10 - Point A

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 To **MASTER MINDS**, Guntur

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**THE END**

<sup>i</sup> 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.