

15. INDEMNITY AND GUARANTEE

QUESTION - WISE ANALYSIS OF PREVIOUS EXAMINATIONS

No.	ABC	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
1.	B	-	1	-	-	-	-	-	-	-	-	-	-	-
2.	C	-	-	-	1	1	-	-	-	-	-	-	-	-
3.	C	-	-	-	-	-	-	-	-	-	-	-	-	4
4.	A	-	-	-	-	-	-	-	-	-	-	-	-	-
5.	A	-	-	-	-	-	8	-	-	5	-	-	-	5
6.	B	-	-	-	-	-	-	-	-	-	-	-	-	-
7.	A	-	-	-	-	-	-	-	-	-	-	-	-	-
8.	A	1	-	-	-	-	-	-	-	-	-	-	-	-
9.	B	-	-	-	-	-	-	-	-	-	-	-	-	4
10.	B	-	-	-	-	-	-	-	-	-	-	-	-	-

Q.No.1. Write about Contract of Indemnity? State the rights of Indemnity holder and Indemnifier? (PM, SM) (N 98, M 99, M 01 - 5M, N09 – 1M)

MEANING: Dictionary meaning of the word 'Indemnify' is 'to compensate'.

- a) When a person assures the other to compensate the probable cost or loss, a contract of indemnity occurs.
- b) In terms of Section 124 of the Act, 'a contract by which one party promises to save the other from loss caused to him
By the conduct of the promisor himself or the conduct of any person is called "Contract of Indemnity".
- c) This is also known as typical form of contingent contract.

PARTIES:

- a) **Indemnifier:** The party who promises to indemnify/ save the other party from loss is known as 'indemnifier'
- b) **Indemnified:** The party who is promised to be saved against the loss is known as 'indemnified'.

For Ex: 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. Here there is contract of indemnity between X and the company.

ESSENTIAL FEATURES OF INDEMNITY CONTRACTS:

- a) **A contract of indemnity is like any other contract:** It must have all the essentials of a valid contract.
E.g.: Free consent, Competent parties, Lawful object, etc.
- b) **A contract of indemnity is a contingent contract:** Since the contract of indemnity assures to indemnify the loss, its performance is contingent upon incurring of such loss by the indemnity holder.
- c) A contract of indemnity may be express or implied from the circumstances of each case.

E.g.: A, an auctioneer, sold certain goods on the instructions of B. Subsequently, it was found out that the goods did not belong to B but to another person C. Now, C claimed damages from A for unauthorised selling of goods belonging to him. A had to give compensation to C. Now A sued B for recovery of the amount of loss he has suffered. Court held that there was an implied contract of indemnity between A and B. It was held that A can recover his loss from B.

RIGHTS OF INDEMNITY HOLDER:

In a contract of indemnity, the promisee i.e., indemnity- holder acting within the scope of his authority is entitled to recover from the promisor i.e., indemnifier the following rights:

- all damages which he may be compelled to pay in any suit
- all costs which he may have been compelled to pay in bringing/ defending the suit and
- all sums which he may have paid under the terms of any compromise of suit

Note:

- It may be understood that the rights contemplated under section 125 are not exhaustive.
- The indemnity holder/ indemnified has other rights besides those mentioned above. If he has incurred a liability and that liability is absolute, he is entitled to call upon his indemnifier to save him from the liability and to pay it off.

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:

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

(N08 – 1M)

Ans: According to Sec 124 of Indian contract Act, 1872 loss should occur due to conduct of promisor or some other person it does not include loss due to natural calamity, on the other hand contract of insurance includes loss due to natural calamity also. Thus contact of insurance though a contact of indemnity but is not fully covered under Indian contract Act, 1872.

Q.No.2. What is meant by Contract of Guarantee? State the special features of contract of guarantee. (Sec 126)

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 default of such third party.

E.g.: X and his friend Y enters into a shop and X says to the shopkeeper Z, "Supply the goods required by Y and if he does not pay to you, I will".

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

- Surety:** The person who gives the guarantee is called Surety.
E.g.: In the aforesaid example, X is called Surety.
- Principal Debtor:** The party in respect of whose default the guarantee is given is called Principal Debtor.
E.g.: In the aforesaid example, Y is called Principal Debtor.
- Creditor:** The person to whom the guarantee is given is called Creditor.
E.g.: In the aforesaid example, Z is called Creditor.

FEATURES OF A CONTRACT OF GUARANTEE:

- Tripartite Agreement:** A contract of guarantee is a tripartite agreement between the Principal Debtor, Creditor and Surety.
- A contract of Guarantee may be either oral or written.
- The principle of implied promise to indemnify surety(one who gives guarantee) is contained in Section 145 of the Act which provides that 'in every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee but no sum which he has wrongfully paid.

- d) The right of surety is not affected by the fact that the creditor has refused to sue the principal debtor or that he has not demanded the sum due from him.
- e) What constitutes consideration in a case of guarantee is an important issue and is laid down in Section 127 of the Act. As per Section 127 of the Act "anything done or any promise made for the benefit of the principal debtor may be sufficient consideration to the surety for giving the guarantee.

For example 'A' had advanced money to 'B' on a bond hypothecating B's property stating that C is the surety for any balance that might remain due after realization of B's property. C was not a party to the bond. He, however signed a separate surety bond two days subsequent to the advance of the money. It was held that the subsequent surety bond was void for want of consideration (Nanak Ram vs. Mehinlal 1877, I Allahabad 487).

NATURE OF SURETY'S LIABILITY:

As per Section 128 of the Act, the liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract.

Thus it can be seen:

- i) the liability of surety is the same as that of principal debtor
- ii) where a debtor cannot be held liable on account of any defect in the document, the liability of the surety also ceases
- iii) **Continue liability:** Surety's Liability continues even if the principal debtor has not been sued or is omitted from being sued. This is for the reason that the liability of the surety is separate on the guarantee.

SIMILAR QUESTION:

1. In a contract of guarantee there are three contracts. Comment.

(N 10, N 13 – 1M, PM)

Ans: Yes. One between Principal Debtor and Creditor, One between Surety and Creditor, and one between Surety and Principal Debtor.

(IMMEDIATELY REFER PRACTICAL QUESTION NO.1 & 2)

Q.No.3. Contract of Indemnity Vs. Contract of Guarantee

(N 17 – 4M)

Basis	Contract of Indemnity	Contract of Guarantee
1. Meaning	Where one party promises to save the other from loss caused to him	It is a contract to perform the promise/ discharge the liability of third party in case of his default.
2. Parties	Indemnifier & indemnity holder.	Creditor, Principal debtor & Surety.
3. No. of Contracts	Only one contract in one deal.	Three contracts in one deal
4. Purpose	To reimburse the loss.	To provide security of a debt or performance of the promisor.
5. Liability	The liability of indemnifier is primary and unconditional.	The liability of a Surety is secondary and conditional.
6. Right to sue the third party	An indemnifier cannot sue the third party.	A Surety can proceed against the Principal debtor in his own name
7. Request	Not necessary that it should be given at the request of indemnity holder.	Surety should give the guarantee at the request of the Principal debtor.
8. Eligible parties	All parties must be competent to contract.	When a minor is Principal debtor – even then the contract is valid.

Q.No.4. Write about specific guarantee and Continuing Guarantee? (M 98, M 99, M 01 –5M)

SPECIFIC GUARANTEE: A guarantee given to a

- Single debt or specific transaction is called 'Specific' or 'Simple' guarantee.
- The specific guarantee ceases to be effective on the repayment of debt.

E.g.: 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.

CONTINUING GUARANTEE [SEC.129]: A guarantee which extends to a series of transactions is called a 'continuing guarantee' (Section 129).

Examples: 1. Where 'A' promises 'B' to be responsible, so long 'B' employs only 'C' to collect his rentals from tenants for an amount of ' 5000/-, there is a continuing guarantee by A to B so long 'C' is employed as rent collector. In other words A stands a guarantor to 'B' for rent collected by 'C'.

- In the continuing guarantee, the liability of surety continues till the performance or the discharge of all the transactions entered into or the guarantee is withdrawn.
- There are two important aspects regarding the revocation of continuing guarantee is:
 - By Notice to the Creditor:** The first aspect is "the continuing guarantee may at any time be revoked by the surety as to future transactions by notice to creditors". However no revocation is possible where a continuing relationship is established.
For instance where '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.
 - By Death of the Surety:** The second aspect is upon the death of surety, the continuing guarantee is revoked for all future transactions in the absence of any contract to the contrary.

Q.No.5. State the rights of a Surety against the Principal Debtor, Creditor?

(N 17 – 5M, N 99 – 5M, PM)

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

The rights of surety are contained in sections 140 and 141 of the Act. These are

1. AGAINST THE PRINCIPAL DEBTOR:

- Right of subrogation:** where a guaranteed debt has become due or default of the principal debtor to perform a guaranteed duty has taken place, the surety upon payment or performance of all that he is liable for, is vested with all the rights which the creditor had against the principal debtor.
The right of the surety is known as the right of subrogation namely the right to stand in the shoes of the creditor.
- Right to securities:** the surety is entitled to the benefit of all securities made available to the creditor by the principal debtor whether the surety was aware of its existence or not.
- Right to recover the amount paid/ Right to indemnity :** the surety is entitled to recover from the principal debtor whatever sums he has rightfully paid.

In this connection the following principles were laid down in *Reed vs. Norris*

- The claim of the surety is restricted to that smaller amount which he may have paid under the principle of "accord and satisfaction". Surety is not entitled for higher amount than what he has paid.

- b) Surety can also claim indemnity for any special damages which he has suffered while discharging his duties
- c) Surety can claim even if he has paid a time barred debt as it is a rightful payment though there are contrary views on this issue.

In all the above instances surety can claim reimbursements only if actual payments have been made and not where he has merely executed promissory notes. [Panth Narayana Murthy vs. Marimuthu (1902) 26 Mad. 322,328]

Where surety becomes surety without the knowledge of principal debtor, he is entitled for all the rights against the principal debtor but not the right to claim an indemnity against the principal debtor.

2. AGAINST THE CREDITOR:

- a) **Right of subrogation:** the surety gets the right of subrogation for all payments and performances he is liable. This right would accrue only when the surety has paid the amount of liability in full.

For example where a creditor had the right to stop the goods or sellers lien, surety would enjoy the same right after he has paid the amount [Imperial Bank vs. SL Katharine Docks 1877 5 Ch.D]

b) Right to securities:

- i) surety is entitled for all securities which the debtor has provided to creditor whether surety is aware of it or not.
- ii) Where a creditor loses any of the security by default or negligence the liability of the surety abates proportionately.
- iii) If a creditor does not hand over the securities to surety he can be compelled to do so.

Classic examples of surety's right are: he is entitled for all mortgage rights which the secured creditor has. But the surety is not entitled for any security provided subsequent to the contract of guarantee

- c) **Right to sue:** surety has a right to require the creditor to sue for and recover the guaranteed debt. This right of surety is known as right to file a 'Quia timet action' against the debtor. There is of course an inherent risk of having to indemnify the creditor for delay and expense
- d) **Right to dismiss:** surety has a right to call upon the creditor to dismiss the person from service if the person whose fidelity is guaranteed by surety is persistently dishonest
- e) **Right to claim set-off:** surety has a right of set off against the principal debtor exactly as a creditor would have.
- f) **Right of option on the claim of the funds:** surety also can compel the creditor where he has claim on two funds, to resort to that fund first on which surety has no claim.
- g) **Right to claim:** surety can claim that he is not liable on the guarantee to the creditor, if it can be proved that principal debtor was incapable of entering into a contract, say because he was a minor. This is on the principle that the liability of the surety is coextensive with that of the principal debtor.

Q.No.6. State circumstances in which contract of guarantee can be treated as invalid?

GUARANTEE WHEN INVALID: Following are the circumstances when a guarantee can be treated as invalid.

- a) **Mis-representation:** When the guarantee has been obtained by means of misrepresentation made directly by the creditor or made with his knowledge and the misrepresentation relates to a material part of the transaction.
- b) **Silence as to material circumstances:** when the creditor has obtained any guarantee by means of keeping silence as to material circumstances.

The expression "keeping silence" implies intentional concealment of a material fact, as distinct from a mere non-disclosure thereof.

There must exist some element of fraud. [Balakrishna vs. Bank of Bengal (1891) 15 Bom. 585]. Ex : A engages B as clerk to collect money for him and B fails to account for some of his receipts. Thereupon, A calls upon B to furnish security for his duly accounting the receipts. C gives the required guarantee. A does not tell C of the fact of a previous misappropriation by B and thereafter B again makes a default. The guarantee would be invalid.

- c) **Failure of joining of other person as co-surety:** when a contract of guarantee is entered into on the condition that the creditor shall not act upon it until another person has joined in it as co-surety and that other party fails to join as such

SIMILAR QUESTION:

1. The right of subrogation in a contract of guarantee is available to the surety. State Correct or Not. (MTP – 1M)

Ans: Correct. Refer above question.

(IMMEDIATELY REFER PRACTICAL QUESTION NO.3, 4, 5, 13)

Q.No.7. State the rights of a Surety against the Co-sureties

As per section 146 of the Act "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".

A co-surety gets a right to recover from other sureties only when he has paid more than his share of debt to the creditor.

LIABILITY OF TWO SURETIES IS NOT AFFECTED BY MUTUAL ARRANGEMENTS:

- As per section 132 of the Act "where two persons contract with a third person to undertake a certain liability and 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, 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, although such third person may have been aware of its existence".
- The foregoing is the position of law applicable when the liability is undertaken jointly by two parties in respect of the same debt. But it is not so when it is in respect of different debts.

For example, a party who accepts a Bill of Exchange for the accommodation of another would plead that he was the accommodating party. This is because the liability undertaken by the acceptor and drawer of the bill is in no sense a joint liability. Though they contract to pay the same sum of money, they contract severally in different ways and subject to different conditions. [Pages vs. Bank of Bengal (1877) 3 Cal. 174].

Q.No.8. When is the Surety discharged from liability?

(M 02 – 10M)

Point out the circumstances in which a surety is discharged from liability by the conduct of the creditor.

(CMA D 10-4M) (PM)(M09 – 1M)

Sections 133 to 139 of the Act lay down the law as to when a surety would be discharged.

These are as follows:

- 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.

Where 'A' stands to 'C' as surety for 'B' for rent payable by 'B' to 'C' for 'C's house and if B & C agree on a higher rent without A's consent, 'A' would stand discharged for the entire rent amount accruing after the date of variance.

2. The surety is discharged if the principal debtor is discharged

- a) by a contract or
- b) any act or
- c) any omission the result of which is the discharge of principal debtor

For instance where 'A' contracts with 'B' to build a house for him and if 'C' stands as surety for 'B', 'C' as surety will stand discharged if 'A' discharges 'B' of his obligation to build house.

Yet another example could be where 'A' agrees to build a house for 'B' if 'B' supplies the necessary timber and if 'C' stands as surety for A's performance. If 'B' fails to supply the timber, both 'A' and 'C' stand discharged.

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

- a) 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.
- b) Even where the claim is barred by limitation, surety is still responsible. In *Krishto Kishore vs. Radha Romun I.L.R. 12 Cal.330*, the plaintiff sued the principal debtor and the surety for arrears of rent. The plaintiff also made the legal representatives of the principal debtor a party after knowing about the death of the principal debtor to avoid the debt being barred by limitation. It was held that even if debt is barred by limitation on account of death of principal debtor, the surety is still liable. The same view was confirmed by Privy Council in *Mahant Singh vs U Ba Yi A.I.R 1939 P.C 110* where it was held that omission of the creditor to sue within the period of limitation does not discharge the surety.
- c) Where the principal debtor compounds [settles] with the creditor regarding the amount or promises not to sue, the surety will be discharged. But a contract for giving time to a debtor is entered into with a third party, the surety will not be discharged.
- d) Where there are co-sureties release of one co-surety would not automatically discharge the other cosureties. Further in between other co-sureties, the released co-surety is not absolved of his liability vis a vis other co-sureties.
- e) The surety would be discharged if the creditor does anything or acts in a manner which
 - i) Is inconsistent with the rights of surety and
 - ii) Impairs the eventual remedy of the surety.

For example, 'A' puts 'M' as the cashier under B and agrees to stand as surety provided 'B' checks the cash every month. 'M' embezzles cash. 'A' was not held to be responsible as B failed to verify the cash every month.

SIMILAR QUESTION:

1. Under what circumstances guarantee made will be treated as invalid?

(RTP – M14)

Ans: Refer above - By invalidation of the contract of Guarantee

(IMMEDIATELY REFER PRACTICAL QUESTION NO. 6, 7, 8, 9, 10, 11& 12)

Q.No.9. Explain the nature and extent of Surety's liability?

(M 98, N 00, N 01 – 5M, M08 – 1M, N 17 – 4M)

1. **Nature of surety's liability:** As per Section 128 of the Act, the liability of the surety is co-extensive with that of the Principal Debtor unless it is otherwise provided by the contract.

Thus it can be seen that:

- a) The liability of surety is same as that of Principal Debtor.
- b) Where a debtor cannot be held liable on account of any defect in the document, the liability of the surety also ceases.
- c) Surety's liability continues even if the principal debtor has not been sued or is omitted from being sued. This is for the reason that the liability of the surety is separate on the guarantee.

2. Commencement of surety's liability:

- a) The liability of Surety arises immediately on default by the Principal debtor (i.e Secondary).
- b) The creditor is not required to:
 - First sue the Principal debtor or
 - First give a notice to the Principal debtor.

3. Surety's liability may be limited: The surety may fix a limit on his liability upto which the guarantee shall remain effective.

4. Surety's liability may be continuous:

- a) The surety may agree to become liable for a series of transactions of continuous nature.
- b) However, the surety may fix
 - A limit on his liability upto which the guarantee shall remain effective or
 - A time period during which the guarantee shall remain effective.

5. Surety's liability may be conditional:

- a) The surety may impose certain conditions in the contract of guarantee.
- b) Until those conditions are met, the surety shall not be liable.

6. 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.

7. Even where the claim is barred by limitation, surety is still responsible [Krishto Kishore Vs. Radha Romun]

8. Where there are co-sureties, release of one co-surety would not automatically discharge the other co-sureties. Further in between other co-sureties, the released co-surety is not absolved of his liability vis a vis other co-sureties.

Q.No.10. C, the holder of an over due 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? (PM)

Facts of the case: C, the holder of a bill contracts with X a third party to give time to B (Principal Debtor).

Provisions and Analysis: According to 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.

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. Hence A is not discharged.

PRACTICAL QUESTIONS

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.

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:

Case (a): If C is a minor

Case (b): If S is a minor

Case (c): If P is a minor

(CMA J12 - 2M)

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. Explain the legal position in the following situations:

- i) 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.
- ii) X guarantees payment to Y of the price of the four laptops sets to be sold by Y to X and to be paid for in a month. Y delivers the sets to X. X pays for them. Later on Y delivers three more sets to X. State the liability of X.

(RTP - M13)

According to Section 129 of the Indian Contract Act, 1872 a guarantee which extends to a series of transactions is called a 'continuing guarantee'. 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.

- i) In the given case guarantee given by A was a continuing guarantee and thus he is accordingly liable to grocer to the extent of Rs, 2000.
- ii) In this case, the guarantee given by X is not a continuing but in fact it is a specific guarantee. Therefore in the given case X is not liable for the price of the three sets which are supplied later to Y.

Q.No.4. 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.

(FOR STUDENTS SELF STUDY) (CMA D12 – 2M)

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

Decision and Reason:

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).

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

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. Upto the time of revocation of guarantee, Nalin had given to Ashok Rs 20,000.

(Similar N15 - 5M) (PM)(M06 – 5M)

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

Discharge of Surety by Revocation: As per section 130 of the India 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.

As per the above provisions, the answer is Yes. Ravi is discharged from all the subsequent loans because it's a case of continuing guarantee. Where as in second case (ii) Ravi is liable for payment of Rs 20,000 to Nalin because the transaction has already completed.

Q.No.6. '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.

(MTP - M16, M 14 – 8M)

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 (Section 43 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.

Hence in the instant 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.7. 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? **(For student self study)**

Facts of the case: B whom is employed in a Bank was given Surety by A. Later, B misappropriates bank's money but they excused him without informing the same to A. Again B has done the same.

Issue or question involved: Is 'A' liable to the Bank or is he discharged from his liability?

Provision: Sec. 139 of the contract Act. – impairing the sureties remedy "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: 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.

Conclusion: In this case the Bank has failed to inform the surety of misconduct of 'B' therefore according to the sec.139 of the Contract Act Surety is discharged from his liability.

Q.No.8. 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.

(CMA D08 – 2M) (PM)(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: It is based on the provisions of Section 137 of the Indian Contract Act, 1872 relating to discharge of surety. The section 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.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.

(PM)(N08 – 5M) (For student self study)

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: Discharge of surety by variance in the terms of the contract.

Analysis: 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 this new arrangement.

Q.No.10. M advances to N Rs 5,000 on the guarantee of P. The loan carries interest at ten percent per annum. Subsequently, N becomes financially embarrassed. On N's request, M reduces the interest to six per cent per annum and does not sue N for one year after the loan becomes due. N becomes insolvent. Can M sue P?

(PM)

Facts of the Case: M advances to N Rs 5,000 on the guarantee of P. The loan carries interest at ten percent per annum, subsequently, N becomes financially embarrassed. On N's request, M reduces the interest to six per cent per annum and does not sue N for one year.

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: M cannot sue P, because a surety is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor, no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety.

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?

(PM) (RTP – N 14)

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. 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.

(PM)(For student self study)

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. In the given case the B omits to supply the timber. Hence C is discharged from his liability.

Q.No.13. '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?

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

1. **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. (Section 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. Answer in the second case would differ 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.

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?
2. A became surety before X for payment of rent by Y under a lease. Subsequently, without A's consent, Y agreed to pay higher rent to X. What is the position of the A?
3. D, a dealer, supplies certain goods to F in separate lots regularly. Z guarantees payment by F upto Rs.45,000 for goods supplied from time to time. Can a Guarantee by Z be revoked?
4. 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?

5. A obtains housing loan from LIC Housing and if B promises to repay what is the nature of contract?
6. 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?
7. '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?
8. On discharging the debt due by the principal debtor to the creditor what is the remedy available to the surety?
9. 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.
10. X, an auctioneer, 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?
11. X asks Y to beat X 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?
12. 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:
 - Case (a): If C is a minor
 - Case (b): If S is a minor
 - Case (c): If P is a minor
13. S gives guarantee for the loans given by Q 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 (a) S gives the guarantee for the payment of the loan of Rs. 60,000 (b) S gives the guarantee for the payment of the loan subject to a limit of Rs. 60,000.
14. 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.
15. Can there be oral guarantee?
16. Can the principal debtor be minor?
17. Can the surety be minor?
18. Can a specific guarantee be revoked?
19. Can a continuing guarantee be revoked?