

Course Name- LL.B 2nd sem
Subject- Special Contract Law
Teacher – Neeru Mangla
Concept –Contracts of Indemnity and
Guarantee (Next Sections)

Nature of surety's liability [Section 128]

The liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract.

Explanation :

- (i) The term “co-extensive with that of principal debtor” means that the surety is liable for what the principal debtor is liable.
- (ii) The liability of a surety arises only on default by the principal debtor. But as soon as the principal debtor defaults, the liability of the surety begins and runs co-extensive with the liability of the principal debtor, in the sense that the surety will be liable for all those sums for which the principal debtor is liable.
- (iii) Where a debtor cannot be held liable on account of any defect in the document, the liability of the surety also ceases.
- (iv) Surety's liability continues even if the principal debtor has not been sued or is omitted from being sued. In other words, a creditor may choose to proceed against a surety first, unless there is an agreement to the contrary.

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.

Nature of Surety's liability can be summed up as

- (a) Liability of surety is of secondary nature as he is liable only on default of principal debtor.
- (b) his liability arises immediately on the default by the principal debtor
- (c) The Creditor has a right to sue the surety directly without first proceeding against principal debtor.

Continuing guarantee (Section 129)

A guarantee which extends to a series of transactions is called a “continuing guarantee”. The essence of continuing guarantee is that it applies not to a specific number of transactions but to any number of transactions and makes the surety liable for the unpaid balance at the end of the guarantee.

Example 1 : A, in consideration that B will employ C in collecting the rents of B’s zamindari, promises B to be responsible, to the amount of `5,000 rupees, for due collection and payment by C of those rents. This is a continuing guarantee.

Example 2 : A guarantees payment to B, a tea-dealer, to the amount of \$ 100, for any tea he may from time to time supply to C. B supplies C with tea to above the value of \$ 100, and C pays B for it. Afterwards B supplies C with tea to the value of \$ 200. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of \$100

- 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.

Liability of two persons, primarily liable, not affected by arrangement between them that one shall be surety on other's default. (Section -132)

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, the 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. (Section 132)

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 no answer to a suit by C against A upon the note.

Discharge of a surety

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

- (i) By revocation of the contract of guarantee
- (ii) By the conduct of the creditor
- (iii) By the invalidation of the contract of guarantee.

By revocation of the Contract of Guarantee

Revocation of continuing guarantee (Section 130) : The continuing guarantee may at any time be revoked by the surety as to future transactions by notice to the creditors.

Example 1 : 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.

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

Revocation of continuing guarantee by surety's death (Section 131)

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. The estate of deceased surety is, however, liable for those transactions which had already taken place during the lifetime of the deceased. Surety's estate will not be liable for the transactions taking place after the death of surety even if the creditor had no knowledge of surety's death.

By conduct of the creditor

By variance in terms of contract (Section 133) : 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.

Example 1 : 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.

Example 2 : A guarantees C against the misconduct of B in an office to which B is appointed by C, and of which the duties are defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, B misconducts himself. A is discharged by the change from future liability under his guarantee, though the misconduct of B is in respect of a duty not affected by the later Act.

Example 3 : C agrees to appoint B as his clerk to sell goods at a yearly salary, upon A's becoming surety to C for B's duly accounting for moneys received by him as such clerk. Afterwards, without A's knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not by a fixed salary. A is not liable for subsequent misconduct of B.

Example 4 : A gives to C a continuing guarantee to the extent of 3,00,000 rupees for any oil supplied by C to B on credit. Afterwards B becomes embarrassed, and, without the knowledge of A, B and C contract that C shall continue to supply B with oil for ready money, and that the payments shall be applied to the then existing debts between B and C. A is not liable on his guarantee for any goods supplied after this new arrangement. Example 5 : C contracts to lend B 5,00,000 rupees on the 1st March. A guarantees repayment. C pays the 5,00,000 rupees to B on the 1st January. A is discharged from his liability, as the contract has been varied, in as much as C might sue B for the money before the 1st March.

By release or discharge of principal debtor (Section 134)

The surety is discharged by any contract between the creditor and the principal debtor; by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor. Example : 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. C is discharged from his suretyship.

Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor [Sector 135]

A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue, the principal debtor, discharges the surety, unless the surety assents to such contract.

Surety not discharged when agreement made with third person to give time to principal debtor [Section 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.

Example : C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with M to give time to B. A is not discharged.

Creditor's forbearance to sue does not discharge surety [Section 137]

Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not in the absence of any provision in the guarantee to the contrary, discharge the surety.

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.

Discharge of surety by creditor's act or omission impairing surety's eventual remedy [Section 139]

If the creditor does any act which is inconsistent with the rights 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.

Example 1 : 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.

Example 2 : A puts M as apprentice to B, and gives a guarantee to B for M's fidelity. B promises on his part that he will, at least once a month, see that M make up the cash. B omits to see this done as promised, and M embezzles. A is not liable to B on his guarantee.

Guarantee obtained by misrepresentation invalid

[Section 142]

Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.

Guarantee obtained by concealment invalid [Section 143] : Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

Example 1 : 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.

Example 2 : A guarantees to C payment for iron to be supplied by him to B for the amount of ` 2,00,000 tons. B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

Guarantee on contract that creditor shall not act on it
until co- surety joins (Section 144)

Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.

Rights of a Surety Rights

- (a) Rights against the creditor
- (b) Rights against the principal debtor,
- (c) Rights against co-sureties

Right against the principal debtor

- (a) Rights of subrogation [Section 140] : 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 invested with all the rights which the creditor had against the principal debtor. This right is known as right of subrogation. It means that on payment of the guaranteed debt, or performance of the guaranteed duty, the surety steps into the shoes of the creditor.
- (b) Implied promise to indemnify surety [Section 145] : In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety. The surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully.

Example 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. He can recover from B the amount paid by him for costs, as well as the principal debt.

Example 2 : 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.

Right against the Creditor Surety's right to benefit of creditor's securities [Section 141]

A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of surety ship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security.

- Example : C advances to B, his tenant, 2,00,000 rupees on the guarantee of A. C has also a further security for the 2,00,000 rupees by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture

