124.“Contract of indemnity” defined. — 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 a “contract of indemnity”.

Illustration

A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of 200 rupees. This is a contract of indemnity.

125.Rights of indemnity-holder when sued. — The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor—

(1) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;

(2) all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorized him to bring or defend the suit;

(3) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorized him to compromise the suit.

126. “Contract of guarantee”, “surety”, “principal debtor” and “creditor”. — A “contract of guarantee” is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the “surety”; the person in respect of whose default the guarantee is given is called the “principal debtor”, and the person to whom the guarantee is given is called the “creditor”. A guarantee may be either oral or written.

127. Consideration for guarantee. — Anything done, or any promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.

Illustrations

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

(b) 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 for C’s promise.

(c) A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

128. Surety’s liability. — The liability of the surety is co- extensive with that of the principal debtor, unless it is otherwise provided by the contract.

Illustration

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.

129. “Continuing guarantee”. — A guarantee which extends to a series of transactions, is called a “continuing guarantee”.

Illustrations

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

(b) 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.

(c) A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C. C pays for them. Afterwards B delivers four sacks to C, which C does riot pay for. The guarantee given by A was not a continuing guarantee, and accordingly he is not liable for the price of the four sacks.

130. Revocation of continuing guarantee. — A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.

Illustrations

(a) 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 5,000 rupees. B discounts bills for C to the extent of 2,000 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 2,000 rupees, on default of C.

(b) A guarantees to B, to the extent of 10,000 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 dishonours the bill at maturity. A is liable upon his guarantee.

131.Revocation of continuing guarantee by surety's death. — 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.

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

Illustration

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.

133.Discharge of surety by variance in terms of contract. — Any variance, made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

Illustrations

(a) 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.

(b) 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.

(c) 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.

(d) A gives to C a continuing guarantee to the extent of 3,000 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.

(e) C contracts to lend B 5,000 rupees on the 1st March. A guarantees repayment. C pays the 5,000 rupees to B on the 1st January. A is discharged from his liability, as the contract has been varied, inasmuch as C might sue B for the money before the 1st of March.

134. Discharge of surety by release or discharge of principal debtor. — 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.

Illustrations

(a) A gives a guarantee to C for goods to be supplied by C to B. C supplies goods to B, and afterwards B becomes embarrassed and contracts with his creditors (including C) to assign to them his property in consideration of their releasing him from their demands. Here B is released from his debt by the contract with C, and A is discharged from his suretyship.

(b) A contracts with B to grow a crop of indigo on A's land and to deliver it to B at a fixed rate, and C guarantees A's performance of this contract. B diverts a stream of water which is necessary for the irrigation of A's land and thereby prevents him from raising the indigo. C is no longer liable on his guarantee.

(c) 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.

135. Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor. — 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.

136. Surety not discharged when agreement made with third person to give time to principal debtor. — 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.

Illustration

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.

137. Creditor's forbearance to sue does not discharge surety. — 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.

Illustration

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.

138.Release of one co-surety does not discharge others. — Where there are co-sureties, a release by the creditor of one of them does not discharge the others; neither does it free the surety so released from his responsibility to the other sureties.

139. Discharge of surety by creditor's act or omission impairing surety's eventual remedy. — 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.

Illustrations

(a) 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.

(b) C lends money to B on the security of a joint and several promissory note made in C's favour by B, and by A as surety for B, together with a bill of sale of B's furniture, which gives power to C to sell the furniture, and apply the proceeds in discharge of the note. Subsequently, C sells the furniture, but, owing to his misconduct and wilful negligence, only a small price is realized. A is discharged from liability on the note.

(c) 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 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.

140. Rights of surety on payment or performance. — 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.

141.Surety's right to benefit of creditor's securities. — A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; 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.

Illustrations

(a) C, advances to B, his tenant, 2,000 rupees on the guarantee of A. C has also a further security for the 2,000 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.

(b) C, a creditor, whose advance to B is secured by a decree, receives also a guarantee for that advance from A. C afterwards takes B's goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged. (c)A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives up the further security. A is not discharged.

142. Guarantee obtained by misrepresentation invalid. — 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.

143. Guarantee obtained by concealment invalid. — Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances, is invalid.

Illustrations

(a) A engages B as 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.

(b) A guarantees to C payment for iron to be supplied by him to B to the amount of 2,000 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.

144. Guarantee on contract that creditor shall not act on it until co-surety joins. — 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.

145. Implied promise to indemnify surety. — 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 sums which he has paid wrongfully.

Illustrations

(a) 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.

(b) 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.

(c) A guarantees to C, to the extent of 2,000 rupees, payment for rice to be supplied by C to B. C supplies to B rice to a less amount than 2,000 rupees, but obtains from A payment of the sum of 2,000 rupees in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.

146. Co-sureties liable to contribute equally. — Where 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.

Illustrations

(a) A, B and C are sureties to D for the sum of 3,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,000 rupees each.

(b) A, B and C are sureties to D for the sum of 1,000 rupees lent to E, and there is a contract between A, B and C that A is to be responsible to the extent of one-quarter, B to the extent of one- quarter, and C to the extent of one-half. E makes default in payment. As between the sureties, A is liable to pay 250 rupees, B 250 rupees, and C 500 rupees.

147. Liability of co-sureties bound in different sums. — Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

Illustrations

(a) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of each 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 30,000 rupees. A, B and C are each liable to pay 10,000 rupees.

(b) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 40,000 rupees. A is liable to pay 10,000 rupees, and B and C 15,000 rupees each.

(c) A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 10,000 rupees, B in that of 20,000 rupees, C in that of 40,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 70,000 rupees. A, B and C have to pay each the full penalty of his bond.

What is contract of indemnity?

The term 'indemnity' simply means to make good the loss or to compensate the party who has suffered some loss. The term 'contract of indemnity' is defined in **Section 124** of the Indian Contract Act as follows — 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 a contract of indemnity. The person who promises to compensate for the loss is called the "indemnifier" and the person to whom this promise is made: or whose loss is to be made good is known as "indemnity-holder" or "indemnified". For example, A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of money. This is a contract of indemnity, here A is the indemnifier and B is the indemnified.

The above definition restricts the scope of contracts of indemnity as it covers only the losses caused by the conduct of the promisor himself or by the conduct of any other person. If a strict view is taken of this definition, it will exclude the losses caused by accidents. In that case insurance contracts should not fall within the purview of contracts of indemnity. But the fact is that all contracts of insurance (except life insurance) are also contracts of indemnity. The intention of law makers had never been to exclude insurance contracts from the purview of contracts of indemnity. That is why we follow the English definition which states "a promise to save another harmless from loss caused as a result of a transaction entered into at the instance of the promisor". This definition includes a promise to make good the loss arising from any cause whatsoever e.g. fire, perils of sea, accidents etc. When a person expressly promises to compensate the other from loss, it is termed as express indemnity. The contract of indemnity is said to be implied when it is to be

inferred from the conduct of the parties or from the circumstances of the case. Even **Section 69** of the Contract Act implies a duty to indemnity in case a person who is interested in the payment of money which another is bound by law to pay, has paid the amount. Similarly, in an auction sale there is an implied contract of indemnity between the auctioneer and the person who asks him to sell goods. For example, A, an auctioneer, sold certain goods on the instructions of B. Later on, it is discovered that the goods belonged to C and not B. So, C recovered damages from A for selling the goods belonging to him. Here A is entitled to recover the compensation from B. In this case there was an implied promise to compensate the auctioneer for any loss which he may suffer on account of the defective title of B.

As we know that contract of indemnity is a special type of contract, therefore, to enforce such contracts it is necessary that all the essentials of a valid contract must be present. In case any one of the essential is missing, the contract cannot be enforced. Thus, if the object or consideration of an indemnity agreement is unlawful, it cannot be enforced. For example, A asks B to beat C, promising to indemnify him against the consequences this cannot be enforced. Suppose B beats C and is fined Rs. 500, B cannot claim this amount from A, because the object of the agreement is unlawful.

What are the rights of indemnity holder?

In pursuance of **Section 125** of the Act the indemnity-holder may recover from the indemnifier (promisor), the following amounts, provided the acts within the scope of his authority:

1. He is entitled to recover all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applied.

2. He is entitled to recover from the indemnifier all costs which he had paid in bringing or defending any suit in respect of contracts of indemnity. In bringing or defending the suit the indemnity-holder must not contravene the orders of the indemnifier and he must act in the same way as a prudent man would have acted under similar circumstances in his own case.

3. He is entitled to recover from the indemnifier, all the amount which he had paid under the terms of the compromise of such suit. However, it is essential that the compromise must not be contrary to the orders of the indemnifier and in compromising the suit, he must act as a prudent man. This right is also available to the indemnity-holder when he paid any amount under any compromise entered by him and authorised by the indemnifier.

What is contract of guarantee?

The object of contract of guarantee is to enable a person to obtain an employment, a loan or goods on credit.

According to **Section 126** of the Indian Contract Act, 'A contract of guarantee' is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the 'surety'; the person in respect of whose default the guarantee is given is called 'the principal debtor'; and the person to whom the guarantee is given is called 'the creditor'. A guarantee may be either oral or written. For example, if A and his friend B enter a trader's shop, and A

asks the trader, "supply the articles required by B, and if he does not pay you. I will." It is a contract of guarantee. The primary liability to pay is that of B but if he fails to pay, A becomes liable to pay. On the other hand, if A says to the trader, "let him (B) have the goods, I will see you are paid", the contract is one of indemnity and not a contract of guarantee.

From the above-mentioned definition of guarantee you will notice that in a contract of guarantee, there are three parties known as creditor, principal debtor and surety. A contract of guarantee is formed when all the three agree. Let us take an example, A and B enter in a shop, and A orders to deliver certain goods to B on credit, The shopkeeper says "I can give goods on credit provided A gives the guarantee for the payment". A promises to guarantee the payment. In this example, B is the principal debtor, A is the surety and the shopkeeper is the creditor and the contract is a contract of guarantee.

A contract of guarantee is an agreement and as such all the essentials of a valid contract must be present. For instance, the contracting parties should be competent to contract. Suppose in the above-mentioned example B is a minor i.e., incompetent to contract. In such a situation A would be regarded as the principal debtor and he will become personally liable to pay. Thus, the incapacity of the principal debtor does not affect the validity of a contract of guarantee. The requirement is that the creditor and the surety must be competent to contract.

Now you may ask that if a contract of guarantee should have all the essentials of a contract then what is the consideration between surety and the principal debtor. It is not necessary that there should be direct consideration between the surety and the creditor i.e., the surety need not be benefited. It is sufficient (for

the purposes of consideration) that something is being done or some promise is made for the benefit of principal debtor. It is presumed that the consideration received by principal debtor is the sufficient consideration for the surety. You would appreciate it if you go through the provision of Section 127, which says: Anything done, or any promise made for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.

On examining the definition of contract of guarantee, you would find that as there are three parties, there are three contracts as well. One contract is between the creditor and the principal debtor, out of which the guaranteed debt arises. Second contract is between the surety and the principal debtor which implies that the principal debtor shall indemnify the surety, if the principal debtor fails to pay and the surety is asked to pay. The third contract is between the surety and the creditor by which surety undertakes (guarantees) to pay the principal debtor's liabilities (debt) if the principal debtor fails to pay.

For a valid contract of guarantee, it is essential that there must be an existing debt or a promise whose performance is guaranteed. In case there is no such debt or promise, there can be no valid guarantee. In fact, a contract of guarantee pre-supposes the existence of a liability enforceable by law. For example, A gives the guarantee to B for the payment of a time-barred debt due from C. This is not a valid contract of guarantee because the primary liability between B and C is not enforceable by law. In case A pays the amount, he cannot recover it from C.

An interesting aspect of the contract of guarantee is that though it is not a contract of *uberrimae fidei* (a contract of absolute good faith) and therefore, it is not necessary for the principal debtor or

the creditor to disclose all the material facts to the surety before he enters into a contract. However, the facts which are likely to affect the surety's decision must be truly represented to him. **Section 142** of the Act provides that 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.

You should also note that not only there should be no misrepresentation but it is also essential that the guarantee must not be obtained by concealing some facts. **Section 143** provides that any guarantee which the creditor has obtained by means of keeping silence to material circumstances is invalid. For example, A employs B as clerk to collect money for him. B fails to account for some of his receipts, and A, in consequence, calls upon him (B) to furnish security for his duly accounting. C gives the guarantee for B's duly accounting. A did not inform C about B's previous conduct. B, afterwards, makes default. Here the guarantee given by C is invalid because it was obtained by concealment of facts by A.

From this discussion, let us summarise the essential features of a contract of guarantee as follows:

i) Existence of a debt, for which some person other than the surety should be primarily liable.

ii) Consideration, but it is not necessary that the surety should be benefited.

iii) All the essentials of a valid contract should be present.

iv) Creditor and surety must be competent i.e.; principal debtor need not be competent to contract.

v) Surety's liability is dependent on principal debtor's default.

vi) Guarantee must not be obtained by misrepresentation.

vii) Guarantee must not be obtained by concealment of material facts.

Distinguish between contract of indemnity and contract of guarantee.

Following are the main points of difference between a contract of indemnity and a contract of guarantee.

i) In a contract of indemnity there are only two parties i.e., indemnifier and the indemnified while in a contract of guarantee there are three parties principal debtor, creditor and the surety.

ii) In a contract of indemnity there is only one contract, whereas in a contract of guarantee, there are three contracts.

iii) In a contract of indemnity the indemnifier undertakes to save the indemnified from any loss caused to him by the conduct of indemnifier himself or the conduct of any other person, while in a contract of guarantee, the surety undertakes for the payment of debts of principal debtor, if the principal debtor fails to pay it.

iv) In a contract of indemnity, the liability of indemnifier is primary and independent, while in a contract of guarantee the liability of surety is secondary i.e., it arises only on the default of principal debtor. The primary liability is that of the principal debtor.

v) In a contract of indemnity, indemnifier's liability arises only on the happening of a contingency, while in a contract of guarantee there is an existing duty or debt, the performance of which is guaranteed by the surety.

vi) In a contract of indemnity, indemnifier acts independently without any request of the debtor or the third party, while in a contract of guarantee the surety guarantees at the request of principal debtor.

vii) In a contract of guarantee, if the principal debtor fails to pay and the surety discharge his debt, the surety can proceed against the principal debtor in his own right, while in a contract of indemnity, the indemnifier cannot sue the third party in his own name unless there is an assignment in indemnifier's favour. If there is no such assignment, the indemnifier must bring the suit in the name of indemnified.

In a contract, if there is a condition precedent for the surety's liability, the surety would only be liable when that condition is fulfilled first. **Section 144** of the Act provides for such situations, that 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. For example, your friend A requires a loan of Rs. 10,000 from the bank. You and two of your friends C and D, agree to guarantee the repayment of loan. C does not sign the necessary documents. You and your friend D are also not liable on this guarantee because it is a condition precedent to your guarantee that the repayment of loan shall be guaranteed by all the three.

In case of a continuing guarantee the surety shall be liable for all such transactions which have taken place upto the time of termination of guarantee.

What are different kinds of guarantee?

Contracts of guarantees may be classified into two types: Specific guarantee and continuing guarantee. When a guarantee is given in respect of a single debt or specific transaction and is to come to an end when the guaranteed debt is paid or the promise is duly performed, it is called a **specific or simple guarantee**. However, a guarantee which extends to a series of transactions, is called a **continuing guarantee** (**Section 129**). The surety's liability in this case would continue till all the transactions are completed or till the guarantor revokes the guarantee as to the future transactions. A fidelity guarantee is a continuing guarantee as it continues for a period of time.

Examples

a) S is a bookseller who supplies a set of books to P, under the contract that if P does not pay for the books, his friend K would make the payment. This is a contract of specific guarantee and K's liability would come to an end, the moment the price of the books is paid to S.

b) On M's recommendation S, a wealthy landlord, employs P as his estate manager. It was the duty of P to collect rent every month from the tenants of S and remit the same to S before the 15th of each month. M, guarantees this arrangement and promises to make good any default made by P. This is a contract of continuing guarantee.

In order to understand continuing guarantee, the following points should be noted:

i) The most important feature of a continuing guarantee is that it applies to a series of separable, distinct transactions. Therefore, when a guarantee is given for an entire consideration, it cannot be termed as a continuing guarantee. For example, K gave his

house to S on a lease for ten years on a specified lease rent. P guaranteed that S would fulfil his obligations. After seven years S stopped paying the lease rent. K sued him for the payment of rent. P then gave a notice revoking his guarantee for the remaining three years. P would not be able to revoke the guarantee because the lease for ten years is an entire indivisible consideration and cannot be classified as a series of transactions. This contract, therefore, cannot be classified as a contract of continuing guarantee.

ii) In deciding whether particular contract of guarantee is a Specific guarantee or a continuing one, you will have to see the intention of the parties as expressed by the terms of the contract and the prevailing circumstances. For example, A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C, C pays for them. Afterwards, B delivers four sacks to C for which C does not pay for. Here A cannot be held liable because it is clear from the terms of the contract that A intended to guarantee only for the payment of price of the first five sacks of flour.

iii) A continuing guarantee may be given for a part of the entire debt or for the entire debt subject to a limit. Let us understand this with the help of an example. S gave guarantee for the loans taken from time to time by P from C. P owes rupees ten thousand to C. S may have given his guarantee in the following two forms:

a) I guarantee the payment of the debt of rupees five thousand by P to C. This is a case of guarantee only for a part of the entire debt.

b) I guarantee the payment of any debts of P due to C subject to a limit of rupees five thousand. This is a guarantee for the payment

of entire debt subject to a specified limit. You will be wondering as to the distinction between the two forms because in both the cases, S appears to be liable for just five thousand rupees. The distinction becomes clear in the event of insolvency of P, the principal debtor. Let us suppose that P has been declared insolvent and his estate can only repay forty paise in a rupee.

In the first case when the guarantee is only for a part of the entire debt, C can recover rupees five thousand from S (the guaranteed amount) and Rs. 2,000 from P's estate (forty percent of the balance of rupees five thousand). C will, therefore, get Rs. 7,000 in all. After paying five thousand to C, S can claim rupees 2,000 from P's estate. However, when the guarantee is for the entire amount subject to a specified limit, C will recover rupees five thousand from S (upto the guaranteed limit) and Rs. 4,000 from P (forty per cent of the entire debt of Rs. 10,000). S would not be able to claim anything from P's estate till the entire amount of rupees ten thousand has been paid to C.

How a continuing guarantee is revoked?

A continuing guarantee may be revoked in any of the following ways:

1) By Notice of Revocation: In respect of future transaction the surety may at any time revoke his guarantee by giving a notice to creditor. In such a case, the surety remains liable for the transactions which have already taken place. For example, A guarantees to B to the extent of Rs. 10,000, that C shall pay for all the goods bought by him during the next three months. B sells goods worth Rs. 6,000 to C. A gives a notice of revocation, C is liable for Rs. 6,000. If any goods are sold to C after the notice of revocation, A shall not be liable for that.

2) By Death of Surety: Unless there is contract to the contrary, the death of surety operates as a revocation of the continuing guarantee in respect to the transactions taking place after the death of surety.

3) In the Same Manner in which the Surety is Discharged: A continuing guarantee is also revoked under all the circumstances under which a surety is discharged from the liability, such as

i) Novation (Section 62)

ii) Variance in terms of Contract (Section 133)

iii) Release or discharge of principal debtor (Section 134)

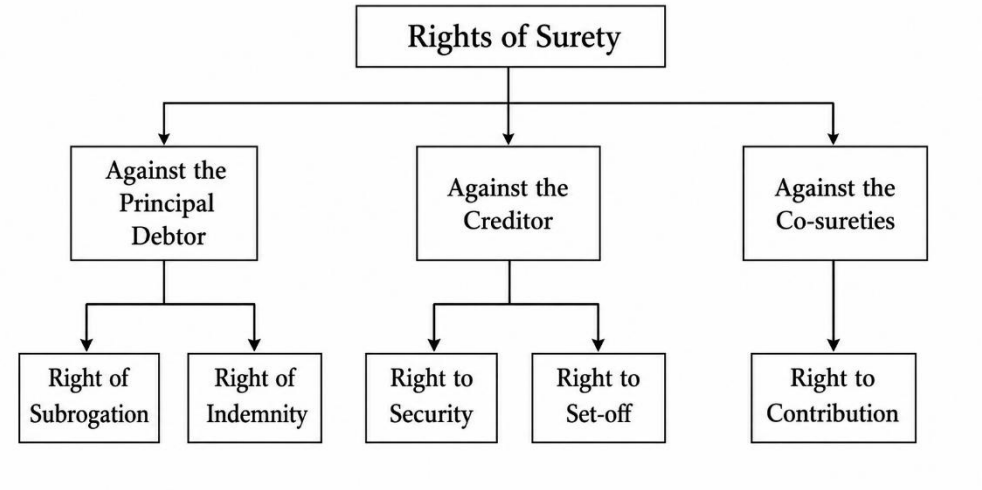
iv) When the creditor enters into an arrangement with the principal debtor (Section 135)

v) Creditor's act or omission impairing surety's eventual remedy (Section 139)

vi) Loss of Security (Section 141).

What are the rights of a surety?

After making a payment and discharging the liability of the principal debtor, the surety gets various rights. These rights can be studied under three heads: (i) rights against the principal debtors. (ii) rights against the creditor, and (iii) rights against the co-sureties.



Rights against the Principal Debtor

The surety has the following two rights against the principal debtor.

1) Right of subrogation: The surety acquires all the rights which the creditor had against the principal debtor. Section 140 lays down, 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 of the surety is called 'subrogation'. It means that on payment of the guaranteed debt, or performance of the guaranteed duty, the surety steps into the shoes of creditor

2) Right of Indemnity: Section 145 of the Act vests in the surety another right i.e., right of indemnity. 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. The surety is not entitled to claim any sums which he has paid wrongfully.

Examples

i) B is indebted to C, and A is surety for the debt. C demands payment from A and, on his refusal, sues him for the amount, A defends the suit, having reasonable grounds for doing so, but he is compelled to pay the amount of the debt with costs. He can recover from B the amount paid by him for costs, as well as the principal debt.

ii) A guarantees to C, to the extent of Rs. 2,000, payment for rice to be supplied by C to B. C supplies to B rice for an amount which is less than Rs. 2,000 but obtains from A payment of the sum of Rs. 2,000 in respect of the rice supplied. A cannot recover from B more than the rice actually supplied.

Rights against the Creditor

1) Right to securities: When the surety has paid off the liabilities of principal debtor to the creditor, he becomes entitled to claim all the securities which were given by the principal debtor to the creditor. Surety has right to all securities whether received before or after the creation of the guarantee (Section 141). It is also immaterial whether the surety has knowledge of those securities or not. For example, on C's guarantee A lent Rs. 5,000 to B. This debt is also secured by an assignment by deed as security for the debt, the lease of B's house. B defaults in paying the debt and C has to pay the debt. On paying off B's liabilities, C is entitled to receive the assignment deed in his favour.

2) Right to set off: When the creditor sues the surety for payment of principal debtor's liabilities, the surety can claim set off, or counter claim if any, which the principal debtor had against the creditor.

Rights against the Co-sureties

When the repayment of debt to the principal debtor is guaranteed by more than one person, they are called Co-sureties. The co-sureties are liable to contribute, as agreed, towards the payment of guaranteed debt. Section 138 provided that where there are co-sureties, the release by the creditor of one of them does not discharge the others, nor does it free the surety so released from his responsibility to the other sureties. Thus, when the payment of a debt or performance of duty is guaranteed by co-sureties and the principal debtor has defaulted in fulfilling his obligation and thereupon the creditor compels only one or more of the co-sureties to perform the whole contract, the co-surety sureties performing the contract are entitled to claim contribution from the remaining co-sureties. According to Section 146, in the absence of any contract to the contrary, the co-sureties are liable to contribute equally. This 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. For example A, B, C and D are co-sureties for a debt of Rs. 2,000 lent by Z to R. R defaults in repaying the loan. A, B, C and D are liable to contribute Rs. 500 each.

According to Section 147 where the co-sureties have agreed to guarantee different sums, they have to contribute equally subject to the maximum of the amount guaranteed by each one. It is immaterial whether sureties are liable jointly or severally, under one contract or under independent contracts and with or without the knowledge, of each other. For example, A, B and C, as sureties for D, enter into three separate bonds, each in a different penalty, viz., A for Rs. 10,000, B for Rs. 20,000 and C for Rs. 40,000. D makes default to the extent of Rs. 30,000. A, B and C are liable to pay Rs. 10,000 each. Suppose thus default was to the

extent of Rs. 40,000. Then A would be liable for Rs. 10,000 and B and C Rs. 15,000 each.

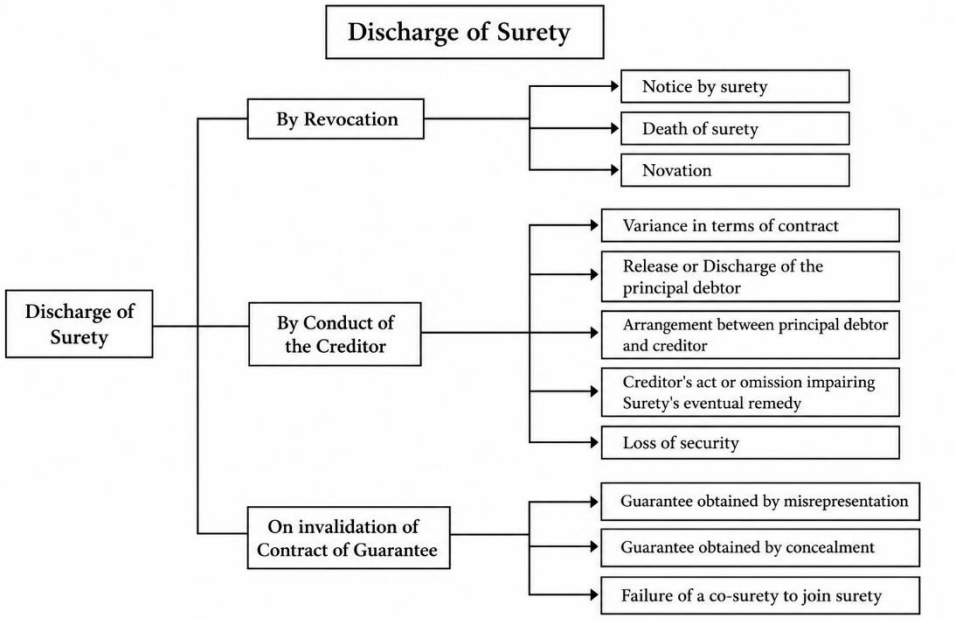
How surety is discharged from liability?

Under any of the following circumstances a surety is discharged from his liability:

i) by revocation of the contract of guarantee,

ii) by the conduct of the creditor, or

iii) by the invalidation of the contract of guarantee.



By Revocation of the Contract of Guarantee

i) Notice by surety: You have learnt that a contract of guarantee may be specific or continuing. A specific guarantee cannot be revoked if the liability has already accrued. Thus, if A lends B a certain sum of the guarantee of C, then C cannot revoke the contract of guarantee. But, if A has not yet given the sum to B, even though the guarantee has been executed by C, C may revoke the contract by giving notice.

Where the guarantee is a continuing one and extends to a series of transactions, it may be revoked by the surety as to future transactions by giving notice to the creditor. The Act contemplates series of distinct and separate transactions to constitute a continuing guarantee which can be revoked by notice.

ii) Death of surety: In the absence of a contract to the contrary, a continuing guarantee is revoked by the death of the surety as to the 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.

iii) Novation: A contract of guarantee is discharged by novation when a fresh contract being entered into, either between the same parties or between other parties, the consideration being the mutual discharge of the old contract. The original contract of guarantee comes to an end and so the surety stands discharged with regard to the old contract.

By Conduct of the Creditor

i) Variance in terms of the contract: A surety is discharged by such conduct of the creditor which has the effect of materially altering the terms of the contract of guarantee. For example, C contracts to lend B Rs. 2,000 on 1st January. A guarantees repayment, C pays the amount to B on 30th August, A is discharged from the liability as the contract has been varied. A surety is liable only for what he has positively undertaken in the guarantee; any alteration made without the surety's consent, in the terms of contract between the principal debtor and the creditor, will discharge the surety as to transactions subsequent to

the variation (**Section 133**). For 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 due to the variance made in the terms without his consent.

ii) Release or discharge of the principal debtor: A surety is discharged if the creditor makes a contract with the principal debtor by which the principal debtor is released, or by any act or omission of the creditor, which results in the discharge of the principal debtor (**Section 134**). For example, A supplies goods to B on the guarantee of C. Afterwards B becomes unable to pay and contracts with A to assign some property to A in consideration of his releasing him from his demands on the goods supplied. Here, B is released from his debt, and C is also discharged from his suretyship. Or, to take another example, where A contracts with B for a fixed price to build a house for B within a specified time, B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber, A is discharged from performing the contract and C is discharged from his suretyship.

But, where the principal debtor is discharged of his debt by operation of law, say, on insolvency, this will not operate as a discharge of the surety. Also, where there are co-sureties, a release by the creditor of one of them does not discharge other co-sureties nor does it free the surety so released from his responsibility to other sureties.

iii) Arrangement between principal debtor and creditor: Where the creditor, without the consent of the surety, makes an arrangement with the principal debtor for composition, or promise to give him time to, or not to sue him, the surety will be discharged (**Section 135**).

However, when the contract to allow more time to the principal debtor is made between the creditor and a third party, and not with the principal debtor, the surety is not discharged (Section 136). For 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.

Similarly, mere forbearance by the creditor to sue the principal debtor or to enforce any other remedy against him, in the absence of any provision in the guarantee to the contrary, does not discharge the surety. For example, A owes Rs. 10,000 to K. The debt is guaranteed by M. The debt becomes payable but K does not sue A for six months after the debt has become payable. This will not discharge M.

iv) By creditor's act or omission impairing surety's eventual remedy: If the creditor does any act which is against 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 (**Section 139**). For example, B, a shipbuilder, contract to build a ship for C for a given sum, to be paid by instalments as the work reaches certain stages (the last instalment not to be paid before the completion of the ship). A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays the last instalment to B. A is discharged by this payment. Take another example, 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 M makes up the cash. B omits to see as promised, and M embezzles. A is not liable to B on his guarantee.

v) Loss of security: If the creditor parts with or loses any security given to him at the time of the guarantee, without the consent of the surety, the surety is discharged from liability to the extent of the value of security (**Section 141**). For example, A, as surety for B, makes a bond jointly with 3 to C to secure a loan from C to B. Later on, C obtains from B a further security for the same debt. Subsequently, C gives up the further security. A is not discharged.

By Invalidation of the Contract

A contract of guarantee, like any other contract, may be avoided if it becomes void or voidable at the option of the surety. A surety may be discharged from liability in the following cases:

i) Guarantee obtained by misrepresentation: When a misrepresentation is made by the creditor or with his knowledge or consent, relating to a material fact in the contract of guarantee, the contract is invalid (Section 142).

ii) Guarantee obtained by concealment: When a guarantee is obtained by the creditor by means of keeping silence regarding some material part of circumstances relating to the contracts, the contract is invalid. (Section 143).

iii) Failure of co-surety to join a surety: When a contract of guarantee provides that a creditor shall not act on it until another person has joined in it as a co-surety, the guarantee is not valid if that other person does not join.