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**VIRTUAL COACHING CLASSES  
ORGANISED BY BOS, ICAI**

**INTERMEDIATE LEVEL  
PAPER 2: CORPORATE AND OTHER LAWS**

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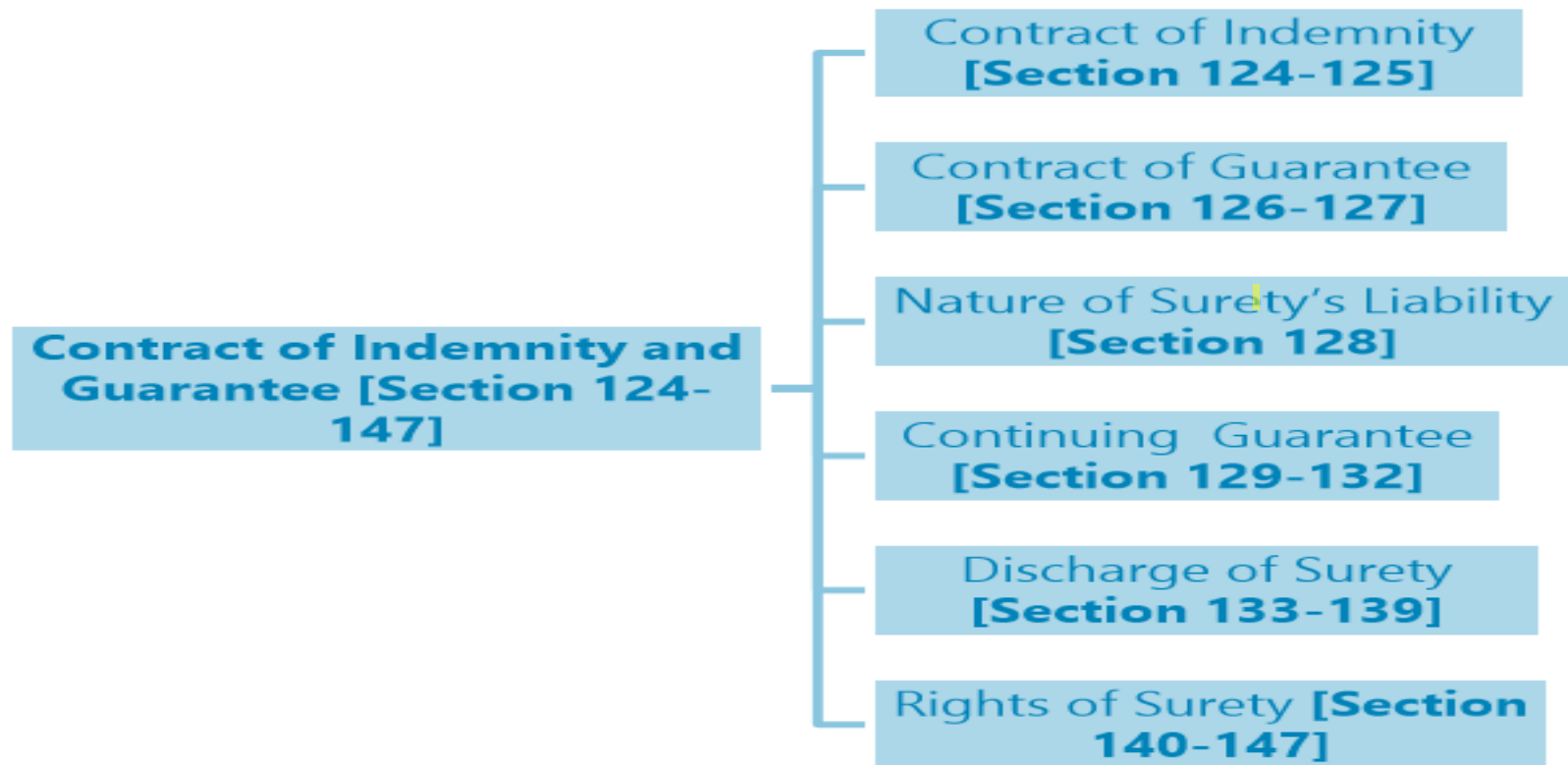
# OTHER LAWS

CONTRACT OF INDEMNITY & GUARANTEE under Indian Contract Act,  
1872



# CHAPTER LAY OUT

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# CONTRACT OF INDEMNITY

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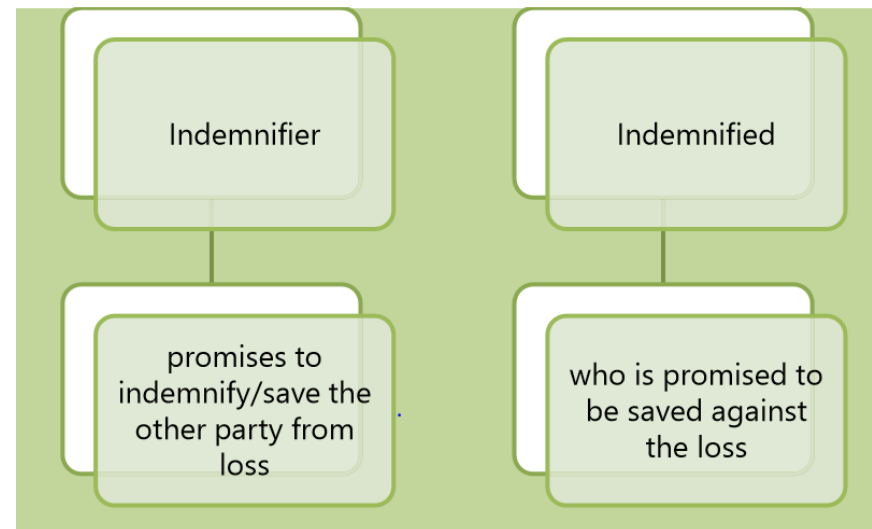
“Indemnity” - to make good the loss or to compensate the party who has suffered some loss or Security against loss

“Contract of Indemnity” is defined under Section 124 of the Indian Contract Act, 1872. It is “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.”

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.



**Example:** Mr. X contracts with the Government to return to India after completing his studies at University of Cambridge and serve the Government for a period of 5 years. If Mr. X fails to return to India, he will have to reimburse the Government. It is a contract of indemnity.





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Example 1 : A may contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a sum of ` 5000/- advanced by C to B. In consequence, when B who is called upon to pay the sum of money to C fails to do so, C would be able to recover the amount from A as provided in Section 124.

Example 2 : X, a shareholder of a company lost his share certificate. He applied for the duplicate. The company agreed to issue the same on the term that X will compensate the company against the loss where any holder produces the original certificate. Here, there is contract of indemnity between X and the company.



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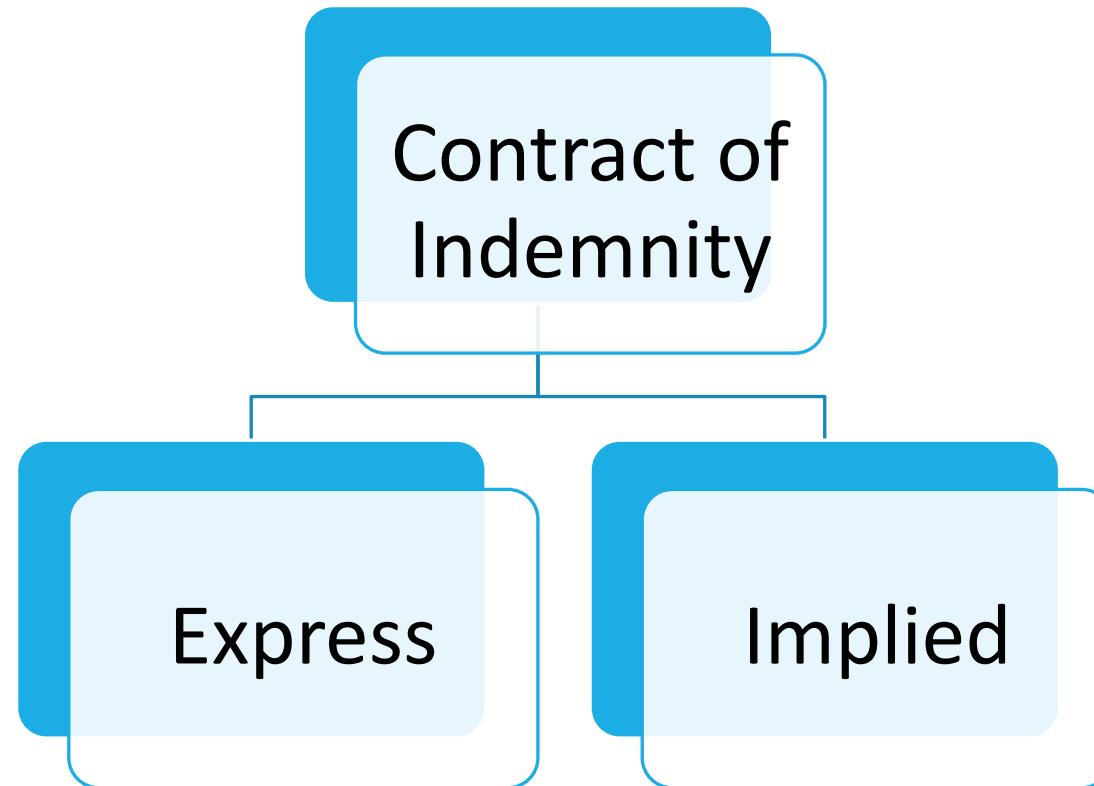
**Example 3:** X may agree to indemnify Y for any loss or damage that may occur if a tree on Y's neighbouring property blows over. If the tree then blows over and damages Y's fence, X will be liable for the cost of fixing the fence.

Note: Definition of indemnity restricts the scope of contracts of indemnity in as much as it covers only the loss caused : (i) By the conduct of the promisor himself, or (ii) By the conduct of any other person. Therefore, loss occasioned by the conduct of the promise, or accident, or an act of God is not covered.



# MODE OF CONTRACT OF INDEMNITY

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# Essentials of a Valid Contract

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- a. Offer and acceptance
- b. Intention to create legal obligation
- c. Consideration
- d. Competency to contract
- e. Free consent
- f. Lawful object
- g. The agreement must not be expressly declared to be void- eg: an agreement in restraint of trade/ marriage etc.
- h. The terms of the agreement must not be vague or uncertain
- i. The agreement must be capable of performance- An agreement to do an impossible act is void.
- j. Legal formalities



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Example: A asks B to beat C promising to indemnify him against the consequences. The promise of A cannot be enforced. Suppose, B beats C and is fined ` 1000, B cannot claim this amount from A because the object of the agreement is unlawful.

*\*A contract of Fire Insurance or Marine Insurance is always a contract of indemnity. But there is no contract of indemnity in case of contract of Life Insurance.*



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**Illustration:** X & Y undergo a compromise where X faces certain losses. In a pre-existing contract between X & Z, it was decided that if X ever undergoes a compromise and faces losses, then such loss will be borne by Z. Such a pre-existing contract between X & Z is a contract of indemnity.

**Illustration:** A is an insurance company and B is his client who has taken the insurance policy of his house from A. B's house catches fire due to gas leakage and B faces a huge loss. The insurance company i.e. A shall indemnify B with such loss against the policy taken by B. Such an insurance contract will be a contract of indemnity.



# Rights of Indemnity—holder when sued (Section 125)

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The promisee (indemnity holder) in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor/indemnifier—

- (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 authorised him to bring or defend the suit;



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- (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 authorised him to compromise the suit.

*The rights contemplated under section 125 are not exhaustive.* 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 is analogous to rights of a surety.



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As per this section, the rights of the indemnity holder are not **absolute or unfettered**.

He must act within the authority given to him by the promisor and must not contravene the orders of the promisor.

He must act with normal intelligence, caution, and care with which he would act if there were no contract of indemnity. Therefore, at the same time, if he has followed all the conditions of the contract, he is entitled to the benefits.



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This was held in the case of ***United Commercial Bank vs Bank of India AIR 1981***. In this case, Supreme Court held that the courts should not grant injunctions restraining the performance of contractual obligations arising out of a letter of credit or bank guarantee if the terms of the conditions have been fulfilled. It held that such LoCs or bank guarantees impose on the banker an absolute obligation to pay.

In the case of **Mohit Kumar Saha vs New India Assurance Co AIR 1997**, Calcutta HC held that the indemnifier must pay the full amount of the value of the vehicle lost to theft as given by the surveyor. Any settlement at lesser value is arbitrary and unfair and violates article 14 of the Constitution of India.



# When does the liability of an indemnifier commence?

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Although the Indian Contract Act, 1872, is silent on the time of commencement of liability of indemnifier, however, on the basis of judicial pronouncements it can be stated that the liability of an indemnifier commences as soon as the liability of the indemnity-holder becomes absolute and certain. This principle has been followed by the courts in several cases.

Example: A promises to compensate X for any loss that he may suffer by filing a suit against Y. The court orders X to pay Y damages of Rs 10000. As the loss has become certain, X may claim the amount of loss from A and pass it to Y.

Limitation period: 3 years





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In **Gajanan Moreshwar vs Moreshwar Madan, AIR 1942**, Bombay High Court observed that the contract of indemnity held very little value if the indemnity holder could not enforce his indemnity until he actually paid the loss. If a suit was filed against him, he had to wait till the judgement and pay the damages upfront before suing the indemnifier. He may not be able to pay the judgement fees and could not sue the indemnifier. Thus, it was held that if his liability has become absolute, he was entitled to get the indemnifier to pay the amount.



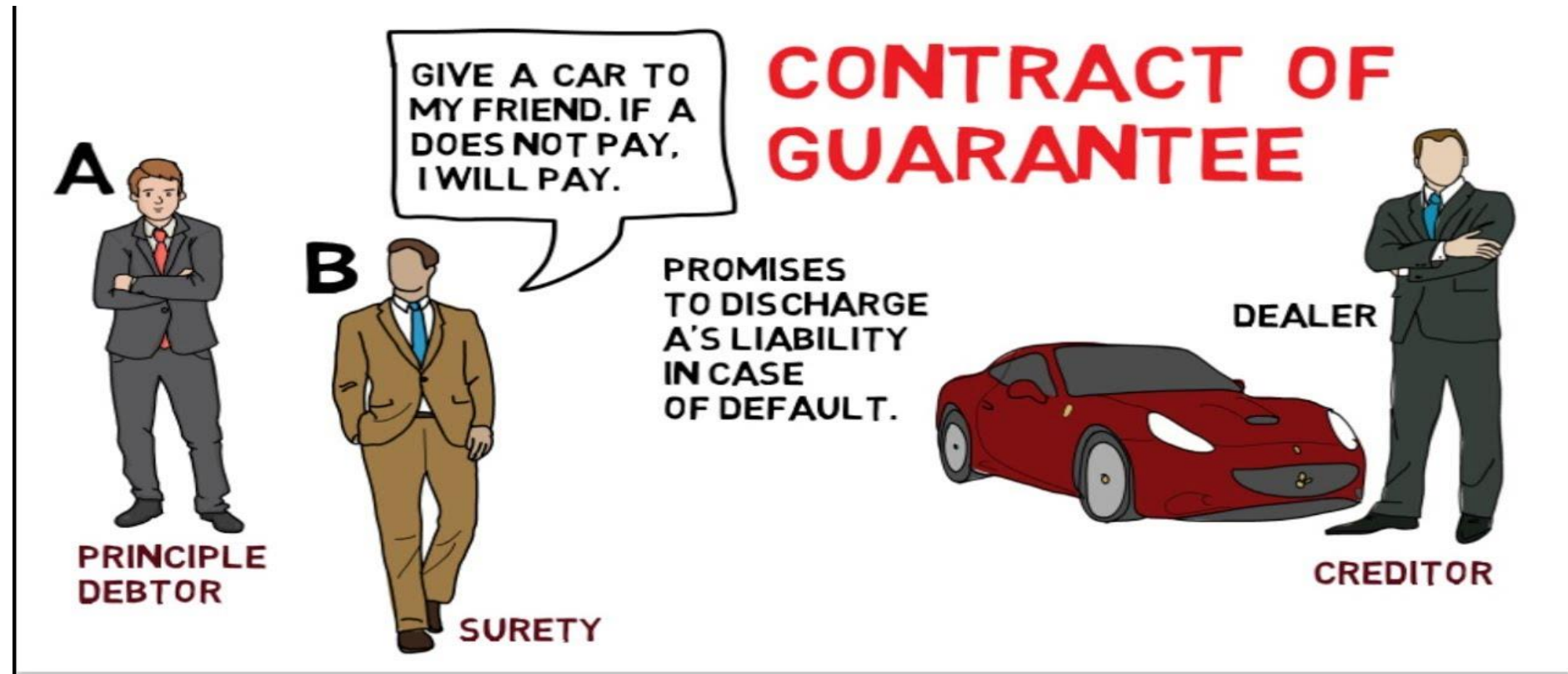
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## **2) Adamson vs. Jarvis [12]**

The plaintiff, is an auctioneer who sold certain cattle on the instruction of the defendant. It subsequently learned out that the livestock sold was not owned by the defendant but belonged to another person who made the auctioneer (plaintiff) liable for the conversion. The auctioneer in turn sued the defendant for indemnity for the loss and damage suffered by him while acting the defendant's direction. The court laid down that the plaintiff has acted upon the request of the defendant and was entitled to presume that if anything went wrong he would be indemnified. Hence, the defendant was order to indemnify the loss and damage to the plaintiff.



# CONTRACT OF GUARANTEE [ Sec.126]

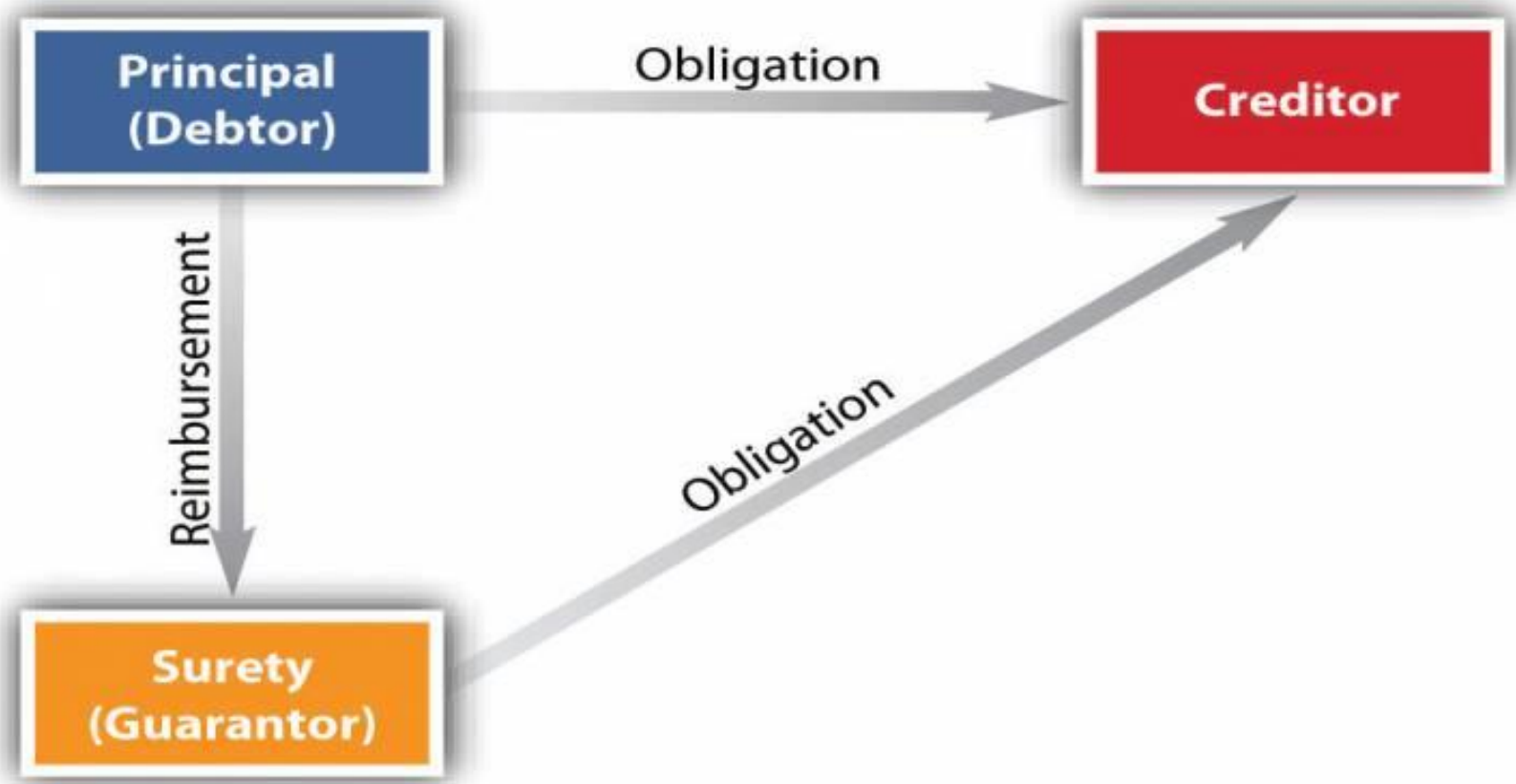




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A contract of guarantee is a contract to perform the promise made or discharge the liability, of a third person in case of his default.

	<b>Surety</b> - person who gives the guarantee,
Three parties are involved in a contract of guarantee	<b>Principal debtor</b> - person in respect of whose default the guarantee is given,
	<b>Creditor</b> - person to whom the gurantee is given





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contract of guarantee is a tripartite agreement between principal debtor, creditor and surety. There are, in effect three contracts

- (i) A principal contract between the principal debtor and the creditor
- (ii) A secondary contract between the creditor and the surety.
- (iii) A implied contract between the surety and the principal debtor whereby principal debtor is under an obligation to indemnify the surety; if the surety is made to pay or perform.

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.



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Example 1 : When A requests B to lend ` 10,000 to C and guarantees that C will repay the amount within the agreed time and that on C falling to do so, he (A) will himself pay to B, there is a contract of guarantee.

Here, B is the creditor, C the principal debtor and A the surety.

Example 2 : Where 'A' obtains housing loan from LIC Housing and if 'B' promises to pay LIC Housing in the event of 'A' failing to repay, it is a contract of guarantee.

Example 3 : X and Y go into a car showroom where X says to the dealer to supply latest model of Wagon R to Y. In case of Y's failure to pay, X will be paying for it. This is a contract of guarantee because X promises to discharge the liability of Y in case of his defaults



**IS ORAL  
AGREEMENT  
ENFORCEABLE IN  
THE COURT OF  
LAW?**





# Essential Features of Contract of Guarantee

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- a) **Principal debt-** If there is no principal debt, there can be no valid guarantee.
- b) **Consideration** (Consideration is the benefit that each party receives, or expects to receive, when entering into a contract).

As per Section 127 consideration received by the principal debtor is sufficient consideration to the surety for giving the guarantee, but past consideration is no consideration for the contract of guarantee. Even if the principal debtor is incompetent to contract, the guarantee is valid. But, if surety is incompetent to contract, the guarantee is void.



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Example 1: 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. As per Section 127, there is a sufficient consideration for C's promise. Therefore the guarantee is valid



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Example 2 : A sell and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year, and promises that if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is a sufficient consideration for C's promise.

Example 3: A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.



# Essential Features of Contract of Guarantee

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**Existence of Liability:** There must be an existing liability or a promise whose performance is guaranteed. Such liability or promise must be enforceable by law. The liability must be legally enforceable and not time barred.

**No misrepresentation or concealment (section 142 and 143):** Any guarantee which has been obtained by the means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid (section 142)

Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances, is invalid (section 143)

Example 1: 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 his previous conduct. B afterwards make default. The guarantee is invalid.



# Essential Features of Contract of Guarantee

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**Writing not necessary: Section 126** expressly declares that a guarantee may be either oral or written.

**Joining of the other co-sureties (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. That implies, the guarantee by a surety is not valid if a condition is imposed by a surety that some other person must also join as a co-surety, but such other person does not join as a co-surety.

*Example (i)* A agrees with B to stand as a surety for C for a loan of Rs. 1000 provided D also joins him as surety. D refuses to join. A is not liable as a surety.



# Types of Guarantee

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**Specific Guarantee-** A guarantee which extends to a **single debt/ specific transaction** is **called** a specific guarantee. The surety's liability comes to an end when the guaranteed debt is duly discharged or the promise is duly performed.

➤ **Example:** A guarantees payment to B of the price of the five bags of rice to be delivered by B to C and to be paid for in a month. B delivers five bags to C, C pays for them. This is a contract for specific guarantee because A intended to guarantee only for the payment of price of the first five bags of rice to be delivered one time [Kay v Groves]



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**Continuing Guarantee [Section 129]**- A guarantee which extends to a **series of transaction** is called a continuing guarantee. A surety's liability continues until the revocation of the guarantee.

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



Point of distinction	Contract of Indemnity	Contract of Guarantee
<b>Number of party/Parties to the contract</b>	there are only two parties namely the indemnifier [promisor] and the indemnified [promisee]	there are three parties creditor, principal debtor and surety.
<b>Nature of liability</b>	The liability of the indemnifier is primary and unconditional	The liability of the surety is secondary and conditional as the primary liability is that of the principal debtor.
<b>Time of liability</b>	The liability of the indemnifier arises only on the happening of a contingency.	The liability arises only on the non performance of an existing promise or non payment of an existing debt.
<b>Time to Act</b>	The indemnifier need not act at the request of indemnity holder	The surety acts at the request of principal debtor.
<b>Right to sue third party</b>	indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour.	surety can proceed against principal debtor in his own right because he gets all the right of a creditor after discharging the debts.
<b>Purpose</b>	Reimbursement of loss	For the security of the creditor
<b>Competency to contract</b>	All parties must be competent to contract	In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid.
<b>Number of Contracts</b>	Only one original and independent contract between indemnifier and indemnified.	There are 3 contracts made between— 1 Creditor and principal debtor 1 Creditor and Surety 1 Surety and Principal debtor





## NATURE AND EXTENT OF SURETY'S LIABILITY [SECTION 128]

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The liability of the surety is **co-extensive** with that of the principal debtor unless it is otherwise provided by the contract. [Section 128]

**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 [S. 129]

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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: 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 the due collection any payment by C of those rents. This is continuing guarantee.



# Continuing Guarantee

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**Example :** 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.



# Continuing Guarantee

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**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, which C does not 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.

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.



# Revocation of Continuing Guarantee

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Continuing guarantee can be revoked under the following circumstances:

**By notice to the creditor:** Section 130 provides that “a continuing guarantee may, at any time, be revoked by surety, as to future transactions, by notice to the creditor.” Thus the surety may terminate his continuing guarantee as regards transactions entered into after the notice. He continues to be liable for transaction entered into prior to the notice. [?]

**By death of surety-** Section 131 provides that the death of the surety operates, , as a revocation to continuing guarantee, so far as regards future transaction. The termination of guarantee shall take place even if there is no notice of death to the creditor.



## **DISCHARGE OF SURETY**

**CIRCUMSTANCES  
UNDER WHICH  
LIABILITY OF SURETY  
COMES TO AN END**

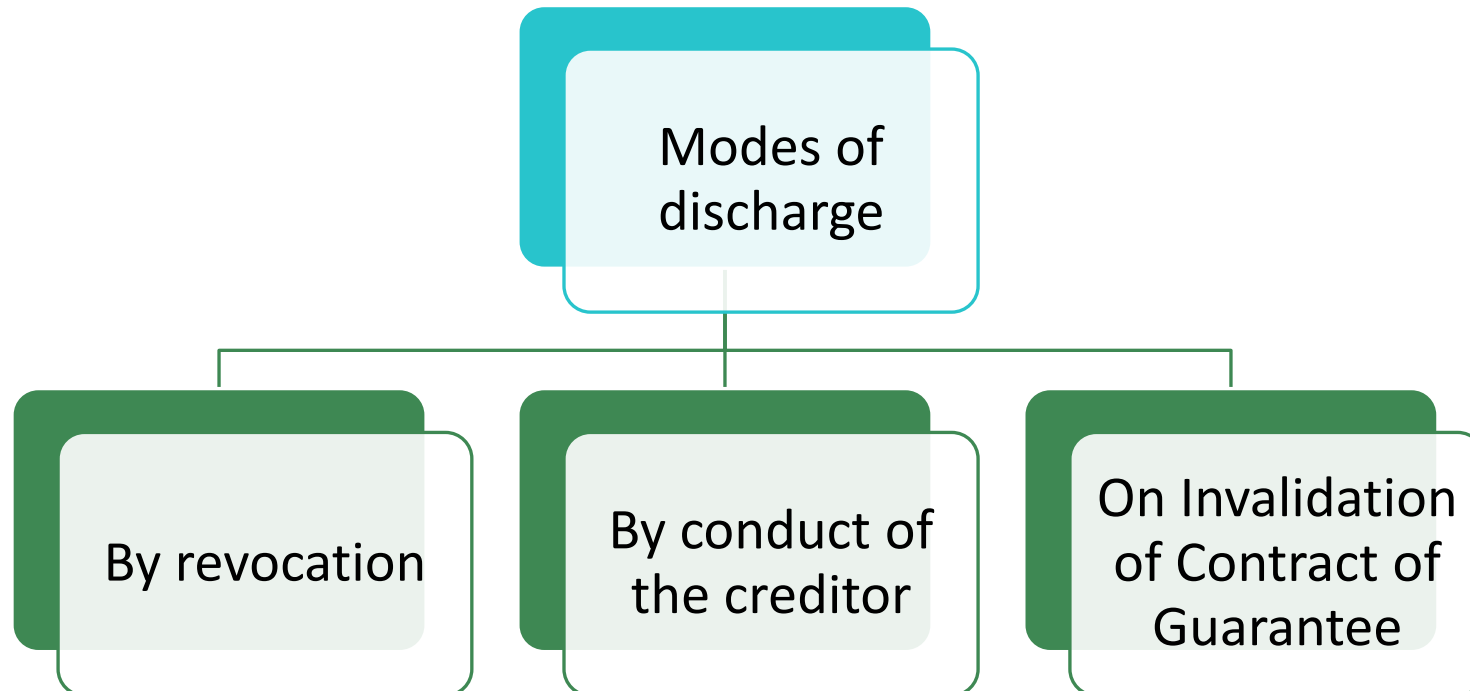
# DISCHARGE OF SURETY

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# DISCHARGE OF A SURETY

A surety is said to be discharged when his liability as surety comes to an end.





# Discharge of Surety by Revocation

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**(a) By Notice (Section 130)** : The continuing guarantee may at any time be revoked by the surety as to future transactions by notice to the creditors. A specific guarantee can be revoked only if liability to principal debtor has not accrued.

➤ **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.





# Conti...

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- **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.
- **Example 3:** X gives guarantee to the extent of Rs. 50,000 for the loans **given from** time to time by A to B. A gave a loan of Rs. 10,000 to B. Afterwards, X gives notice of revocation. X is discharged from all liability to A for any loan granted after the revocation of guarantee but he is liable to A **for Rs. 10,000** on default of B.



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- **(b) By surety's death (Section 131) :** In the absence of any contract to the contrary, the death of surety operates as a revocation of a continuing guarantee as to the future transactions taking place after the death of surety. However, the surety's estate remains liable for the past transactions which have already taken place before the death of the surety.
  
- **(c) By novation [Section 62] :** The surety under original contract is discharged if a **fresh contract is entered** into either between the same parties or between the other parties, the consideration being the mutual discharge of the old contract.



# Discharge of Surety by Conduct of the Creditor

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**A. Change 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 surety ship by the variance made without his consent, and is not liable to make good this loss.



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- **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.



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**But variation which is not substantial or material or which is beneficial to the surety will not discharge him of his liability.** In *M.S Anirudhan v Thomco's Bank Ltd. AIR 1963 SC 746*, the surety guaranteed the repayment of loan provided by the bank to the principal debtor of only upto Rs.25,000. Subsequently, since the bank was willing to provide loan only upto Rs. 20,000, the principal debtor reduced the amount to Rs. 20,000 in the guarantee form and without intimation to the surety gave it to the bank which was then accepted. On default by the principal debtor, the court held that the surety's liability was not discharged as the alteration was beneficial to him and not substantial.



# Conti....

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**B. By release or discharge of principal debtor (Section 134) :** The surety is discharged if the creditor:

- i. enters into a fresh/ new contract with principal debtor; by which the principal debtor is released, or
- does any act or omission, 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 surety ship.



# Conti....

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c) **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 **promises not to sue**, the principal debtor, discharges the surety, unless the surety assents to such contract.



# Conti...

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## D. Creditor's act or omission impairing surety's eventual remedy [sec .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 installments as the work reaches certain stages. A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays to B the last two installments. A is discharged by this prepayment.





# Exception: When Surety Not Discharged

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- **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 Invalidation of the Contract of Guarantee

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



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➤ **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.

**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 SURETY**

### ***RIGHTS AGAINST***

- ✓ **Creditor**
- ✓ **Co-Surety**
- ✓ **Principal Debtor**

# RIGHTS of A SURETY

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# Rights of a Surety

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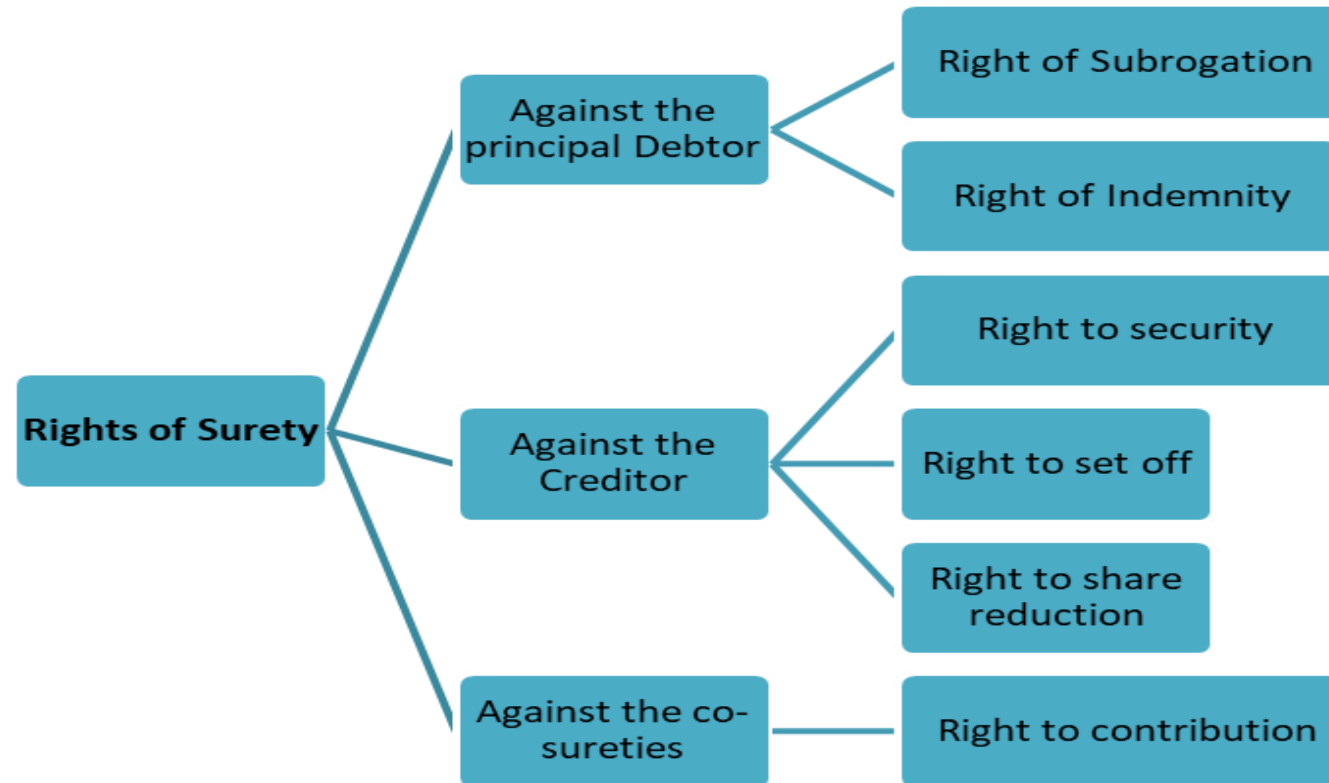
The surety enjoys the following rights :

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

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# Right Against the Principal Debtor

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- **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.
  
- **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 not sums which he paid wrongfully



# Conti...

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- **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.





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**Example 3 :** A guarantees to C, to the extent of 2,00,000 rupees, payment for rice to be supplied by C to B. C supplies to B rice to a less amount than 2,00,000 rupees, but obtains from A payment of the sum of 2,00,000 rupees in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.



# Right Against the Creditor

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**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 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.

Thus,

- a. Surety is entitled to all the securities which the debtor has provided to creditor whether surety is aware of it or not
- b. Where a creditor loses any of the security by default or negligence the liability of the surety abates proportionately
- c. If a creditor does not handover the securities to the surety he can be compelled to do so.



# Conti...

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- **Example 1** : C advances to B, his tenant, 2,00,000 rupees on the guarantee of A. C has also a further security for the 2,00,000 rupees by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.
- **Example 2** : 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.
- **Example 3** : A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives the up the further security, A is not discharged.



# Conti...

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- **Right to set off:** If the creditor sues the surety, for payment of principal debtor's liability, the surety may have the benefit of the set off, if any, that the principal debtor had against the creditor.
  
- **Right to share reduction:** The surety has right to claim proportionate reduction in his liability if the principal debtor becomes insolvent.



# Rights Against Co- Sureties

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## Rights against co-sureties

*“Co-sureties (meaning)- When the same debt or duty is guaranteed by two or more persons, such persons are called co-sureties”*

- **(a) Co-sureties liable to contribute equally (Section 146) :** Equality of burden is the basis of Co-suretyship. This is contained in section 146 which states that “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”.



# Conti...

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- **Example 1** : A, B and C are sureties to D for the sum of 3,00,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,00,000 rupees each.
- **Example 2** : A, B and C are sureties to D for the sum of 1,00,000 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 25,000 rupees, B 25,000 rupees, and C 50,000 rupees.



# Conti...

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**(b) Liability of co-sureties bound in different sums (Section 147)** The principle of equal contribution is, however, subject to the maximum limit fixed by a surety to his liability. Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

➤ **Example 1 :** A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 3,00,000 rupees. A, B and C are each liable to pay 1,00,000 rupees.



# Conti....

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- **Example 2 :** A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 4,00,000 rupees; A is liable to pay 1,00,000 rupees, and B and C 1,50,000 rupees each.
- **Example 3 :** A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 7,00,000 rupees. A, B and C have to pay each the full penalty of his bond.





# Conti...

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## LIABILITY OF TWO SURITIES IS NOT AFFECTED BY MUTUAL AGREEMENT

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.



# Question

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`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?



# Answer

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**Section 130 - revocation of a continuing guarantee as to future transactions : 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.

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.



# Question

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*Mr. X, is employed as a cashier on a monthly salary of ` 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 ` 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 ?*



# Answer

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If the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change. 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. [Section 133, Indian Contract Act, 1872].



# Question

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A agrees to sell goods to B on the guarantee of C for the payment of the price of goods in default of B. Is the agreement of guarantee valid in each of the following alternate cases:

Case 1. If A is a Minor

Case 2: If B is a Minor

Case 3: If C is a minor.



# Answer

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Case 1: The agreement of guarantee is void because the creditor is incompetent to contract.

Case 2: The agreement of guarantee is valid because the capability of the principal debtor does not affect the validity of the agreement of the guarantee.

Case 3: The agreement of guarantee is void because the surety is incompetent to contract.



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**A guarantee which extends to a series of transaction is known as :**

- A) Specific guarantee
- B) Continuing guarantee
- C) Both (A) and (B)
- D) None of the above





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**A contract to perform the promise, or discharge the liability, of a third person in case of default is known as :**

- A) Contract of indemnity
- B) Contract of guarantee
- C) Contingent contract
- D) Quasi contract



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# THANK YOU