

CRITICAL APPRAISAL OF THE ROLE OF SURETY IN GUARANTEE

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Abstract

The term surety is used to the person who acts as a third - party security for a contract between a creditor and principle debtor. The creditor is the one who provides services or goods to the Principle Debtor on the guarantee provided by the surety, who will make the payment or performance in case of default by the Principle Debtor. The surety is entitled to recover all the costs incurred back from the Principle Debtor. This is known as a Contract of Guarantee and has been defined in the Indian Contract act from section 126 to 147. In the English law it is defined as "a promise to answer for the debt, default or miscarriage of another.". This paper aims to explain the various roles that a surety assumes in the contract of guarantee; that of the Principle Debtor, Creditor, Beneficiary and how his rights and duties are altered according to the role partaken.

Keywords – Surety, Principle Debtor, Creditor, Liability, Discharge, Guarantee

I. Introduction

A contract of guarantee is born only upon the default of the principal debtor and is hence, conditional in nature, subject to the performance or non - performance of the principle debtor.²¹ It is collaterally undertaken to enable a person to procure a loan, or goods on credit or an employment

It can be either expressed or implied.²² It is severed and completely different from the original contract between the parties and does not follow the terms of the original contract²³. In the event of the death of the surety, the legal representatives would be bound by law to perform the functions of surety.²⁴ Although the principal-debtor has not signed the arbitration clause in the agreement of guarantee, the clause may nonetheless bind the principal-

debtor by implication.²⁵ A deal for arbitration between a creditor, a debtor, and one surety, however, does not bind further sureties²⁶.

The paper will discuss the multiple - personalities possessed by the surety throughout the contract of guarantee. Multi personality, as used in every day language refers to a personality disorder in which a person takes shape of alternate identities exhibiting behaviour equivalent to that of various personalities.²⁷ However, in this chapter it is concerned with the Multiple dimensions adopted by the surety throughout the contract of guarantee, including that of the surety itself, that of the principal debtor and that of the creditor.

II. In the shoes of surety

There are two essentials for a contract of surety. Firstly, the presence of recoverable Principal Debt and the existence of consideration.

²¹ Satyanarayan Kamal Kumar v Birendra Pr Singh, AIR 1979 Cal 197 [LNIND 1979 CAL 14] .

²² Blueorchard Microfinance Fund v Share Microfin Ltd, (2015) 192 Comp Cases 9 : (2016) 3 ALD 269 .

²³ National Highways Authority of India v Ganga Enterprises, AIR 2003 SC 3823

²⁴ Durga Priya Chowdhury v Durga Pada Roy, AIR 1928 Cal 204

²⁵ Chand Chits and Finance Pvt. Ltd. v Super Advertisers, AIR 1992 Del 85

²⁶ S N Prasad v Monnet Finance Ltd., AIR 2011 SC 442 : (2011) 1 SCC 320 .

²⁷ Klufft, R.P., 1991. Clinical presentations of multiple personality disorder. *Psychiatric Clinics of North America*, 14(3), pp.605-629.

Secondly, the consideration provided by each party of the contract. The consideration for the creditor in this case is the security provided by the debtor as collateral in case of failure of payment. The consideration for the debtor is the safety or the promise to pay by the surety. The consideration from the creditor to the surety flows in the form of anything done or any promise made for the benefit of the principal debtor.²⁸ For example, *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*²⁹. Even if the creditor agrees to not bring an action against the principal debtor, as per the wish of the surety is also considered as consideration.³⁰ *However it was to be duly that –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.*³¹

Without consideration, the court held that neither the guarantee nor the payment could be invoked.³²

The surety also holds certain rights against co-sureties in section 146, stating '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'³³. This is similar to the concept of joint promisors observed in case of an ordinary contract, wherein, each

party has equal contribution and liabilities as the other parties.³⁴

The creditor has the right to sue to the Principal Debtor without the need of the surety, however this does not discharge the liability of the surety.³⁵ Even the surety can be sued in the absence of the principal debtor.³⁶ This can sometimes put the surety in a vulnerable position as in a relationship based on trust and confidence, the surety can come under undue influence or misrepresentation, hence it becomes important for the courts to protect the rights of the surety. This can be seen in the case of *Barclays Bank Plc v. O'Brien*³⁷, where court absolved the liability of a wife standing as surety for her husband debt's. Even Banks have to consider whether the person would be put into a disadvantageous position upon assuming the sureties' position and accord the title accordingly.³⁸ Even in the case of *Hargopal Agarwal v. SBI*, the trial court held the position of a plaintiff as surety for his son to be free and not under the effect of undue influence from the bank. However, Madras high court believed the plaintiff to be unduly influenced by the bank and hence absolved him from his liability as a surety.³⁹

However commercial sureties who were in direct communication with the creditor were believed to be capable enough to protect their own rights and could not be absolved of their liability.⁴⁰ The liability of the surety could also be discharged in the off chance of default on part of the creditor, consequently discharging the liability of the principal debtor. The liability of surety could be revoked by any prescribed in section 130 – 139 of the Indian Contract Act.

III. In the shoes of the creditor

²⁸ Indian Contract Act, 1872, § 127, No. 9, Acts of Parliament, 1872 (India)

²⁹ Prasanjit Mahtha v United Commercial Bank Ltd, AIR 1979 Pat 151

³⁰ Madan Lal Sobe v Rajasthan State Industrial Development & Investment Corpn Ltd, (2006) 135 DLT 554

³¹ Indian Contract Act, 1872, § 137, No. 9, Acts of Parliament, 1872 (India)

³² Ujjal Transport Agency v Coal India Ltd, AIR 2011 Jha 34

³³ Indian Contract Act, 1872, § 146, No. 9, Acts of Parliament, 1872 (India)

³⁴ Indian Contract Act, 1872, § 43, No. 9, Acts of Parliament, 1872 (India)

³⁵ Karnataka State Industrial Investment & Development Corporation Ltd v SBI (2005) 1 CLT 437

³⁶ Vijay Singh Padode v Sicom Ltd. (2000) 4 Mah LJ 772

³⁷ Barclays Bank Plc v. O'Brien, (1994) 1 AC 180

³⁸ Royal Bank of Scotland v Etridge, (1998) 4 All ER 705 (CA)

³⁹ Hargopal Agarwal v. SBI, AIR 1956 Mad 211.

⁴⁰ Orna S. Paglin, From Favorite of the Law to Intermediate Surety: A Transformation in the Law of Suretyship, 23 NEW ENG. L. REV. 67 (1988). pg 68-69

The final personality that the surety embodies in a contract of guarantee is that of the creditor. The provision for this has been stated as – *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.*⁴¹ Here the word *invested* draws attention as it signifies an inherent right that the surety possesses from the initiation of the contract. This provision not only informs a particular right of the creditor, rather a bundle of rights available to the surety. These rights are inherent and contingent but are only actuated in the event of default in the contract. Playing the role of creditor, the surety is bound to receive reimbursement from the principal debtor for the amount paid on his behalf. This is described as the right to subrogation or the right to be indemnified. It exists as an implied contract between the principal debtor and the surety wherein the former has to compensate the latter for all the costs rightly covered by him.⁴²

Further, *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.*⁴³ This explains that the surety is entitled to the same security available with the creditor regardless of knowledge of the same, and shall be discharged of his responsibility if the security is compromised at the fault of the creditor.⁴⁴

While stepping into the shoes of the creditor, the surety also becomes a beneficiary to the contract.

IV. Surety from the POV of Principal Debtor

If the principal debtor defaults, the surety enters his shoes and makes the payment on his behalf. This is so because *the liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract.*⁴⁵ The former part of the sentence discusses the rule and the segment after the insertion of a comma prescribes the exception to the rule. The case of *Central Bank of India v. C.L. Vimla* Bombay High Court that if the creditor, in this case the Central Bank of India, had followed due process of law to procure payment from the principal debtor, could ask the surety, in this case the defendant C.L. Vimla directly for payment on default of the principal debtor without approaching the principal debtor first.⁴⁶ Since their liabilities are co-extensive, if the principle debtor gets discharged of his liability, the liability of the surety would also get absolved. Similarly if the liability of the principal debtor increases, the liability of the surety would also increase. The liability of the surety extends not only to the indebted amount but also the additional obligations of the principal debtor. The surety's duty also grows proportionately if the principal debtor's obligation increases, for instance because of interest or penalties. Similar to this, the surety is additionally responsible for the whole amount of the debt if the principle debtor is unable to pay it back. However, if the guarantee specifies a maximum limit, then the surety's liability is limited to that amount.

The liability of the surety would apply even in an event of lack of knowledge on part of surety⁴⁷, on unauthorized acts of the principal debtor⁴⁸ or without prior impediment of the principal debtor.⁴⁹

⁴¹ Indian Contract Act, 1872, § 140, No. 9, Acts of Parliament, 1872 (India)

⁴² Indian Contract Act, 1872, § 147, No. 9, Acts of Parliament, 1872 (India)

⁴³ Indian Contract Act, 1872, § 141, No. 9, Acts of Parliament, 1872 (India)

⁴⁴ Wuff & Billing Jay, (1872) 7 QB 756

⁴⁵ Indian Contract Act, 1872, § 128, No. 9, Acts of Parliament, 1872 (India)

⁴⁶ *Central Bank of India v. C.L. Vimla*, (2015) 7 SCC 337

⁴⁷ *Jagdish Sarda v. SBI*, AIR 2016 Cal 2

⁴⁸ *Bank of India v. Surendra Kumar Mishra*, (2003) 1 BC 45 (Jhar.)

⁴⁹ *Bank of Bihar Ltd. v. Damodar Prasad*, AIR 1969 SC 297

V. Discharge of Liability of the surety

The release of liability of the surety can be achieved by one of two ways, by discharge of principal debtor or by any act or omission of the creditor the legal course of which is the release of liability of principal debtor.⁵⁰ For example, *A contracts with B for a fixed price to build a house for B within a stipulated time. B supplying the necessary timber. C guarantees A's performance of the contract. B omits to supply the timber. C is discharged from his suretyship.* A pivotal question however is posed regarding the validity of this section when the liability of the surety is reduced owing to a provision established by a statute, referring to the Debt Relief Act. This ambiguity came around with the conflicting judgement of two high courts, wherein the Nagpur bench held that the intention of the statute was to provide relief to the principal debtor rather than the surety.⁵¹ However Madras High Court argued applying the provisions of the Madras Agriculturists' Debt Relief Act, that, the surety is liable only for the reduced amount of the debt.⁵² The judgement of Madras High Court was further upheld, believing that a view contrary to theirs would be detrimental to the interest of the debtor.⁵³

If the creditor forebears from suing the debtor, this would also relieve of liability of the surety provided that the surety assents to the same.⁵⁴

VI. Conclusion

While the role of a principal debtor causes perilous hardship to the surety, he achieves economic gain from his position as a creditor. He further has rights against both these parties and along with other co – sureties, involved in the contract. He can also play the role of a beneficiary in this contract. In addition to the codified law, court decisions have profoundly developed and interpreted India's laws on suretyship. Given the complexity of the surety,

the courts have adopted a number of rules to govern suretyship. One of the main concepts that the courts developed is the strictissimi juris principle, which asserts that a surety's liability should be severely construed. In other words, a surety's obligation will not be increased by the courts beyond what is clearly stated in the suretyship contract.

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⁵⁰ Indian Contract Act, 1872, § 134, No. 9, Acts of Parliament, 1872 (India)

⁵¹ Balkrishna v. Atmaram, AIR 1944 Nag 277

⁵² Subramania Chettiar v. Aypunni Mani v. M.P.Narayanawami Gounder, AIR 1951 Mad 48

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