

A CRITICAL EVALUATION OF THE VARIED ROLES PLAYED BY A SURETY IN CONTRACTS OF GUARANTEE

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INTRODUCTION

Charles Stross once said, “Contract law is essentially a defensive scorched-earth battleground where the constant question is, “If my business partner was possessed by a brain-eating monster from beyond space time tomorrow, what is the worst thing they could do to me?”¹”

From this statement, we can conclude that a legally binding agreement in which each party accepts a specific obligation that must be fulfilled is known as a Contract. Contractual legal problems most frequently occur when one party does not uphold its end of the bargain. When one party breaks a contract by failing to execute, the other party may frequently seek monetary compensation or, in some rare circumstances, may ask the court to compel the breaching party to carry out their end of the bargain.

This assignment specifically focuses on Contracts of Guarantee. The definition of “guarantee” according to the Black Laws Dictionary is-

“The assurance that a legal contract will be duly enforced.”²

A Contract of Guarantee is a triangular arrangement that includes:

- Principal Debtor;
- Creditor;
- Surety³

These have been defined under Section 126 of the Indian Contract Act along with the term Contract of guarantee as-

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¹Charles Stross, <https://www.azquotes.com/quote/649131>. (April 21, 2023)

²Black’s Law Dictionary, (2nd Edn.).

³Mahabir Shum Sher v. Lloyds Bank, AIR 1968 Cal 371, 377.

“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.”⁴

This assignment specifically focuses on the character of Surety and his multi-faceted or multiple-personality as per the law of contracts.

MULTIPLE PERSONALITIES OF SURETY EXPLAINED THROUGH CASE LAWS

The term multiple personality or multi-faceted personality implies a person who has various abilities i.e., a personality with various sides to it⁵. This is quite similar to the character of Dr. Jekyll from Robert Louis Stevenson’s book *The Strange Case of Dr. Jekyll and Mr. Hyde* where the protagonist essayed the part of both the scientist Dr. Jekyll as well as his evil alter-ego Mr. Hyde.

The character of Surety in similar fashion essays a handful of roles such as those of Surety himself, a Principal Debtor, an Indemnifier, a Creditor, and a Co-Surety. The assignment in its due course shall explain the change in personality with respect to the various provisions as per the Indian Contract Act, 1872.

SURETY AS A SURETY

The Indian Contract Act under **Section 126** gives the definition of Surety as-

“The person who gives the guarantee is called the ‘surety’”⁶

A Surety promises a creditor that, in the event of the principal debtor's default, they will satisfy a commitment made by the Principal Debtor or release the third party from liability. As a result, the Surety assures the creditor of the major Debtor's performance⁷.

⁴Indian Contract Act, 1872, § 126.

⁵Cambridge Dictionary, <https://dictionary.cambridge.org/dictionary/english/multifaceted>. (April 21, 2023)

⁶Indian Contract Act, 1872, § 126.

⁷Mountstephen v. Lakeman, (1871) LR 7 QB 196, 202.

But, to do the same some consideration is required. This is expressed under **Section 127** of the Contract Act as- *“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.”*⁸

This implies that either the Creditor or the Principal Debtor may provide consideration for the Surety's promise⁹. Although the Surety may profit from the consideration, it is not required that the Surety gain from the consideration in a guaranteed contract.

SURETY AS A PRINCIPAL DEBTOR

There are certain instances when the Surety is made to pose as a Principal Debtor. One such situation occurred in the case of **Maharaja of Benaras v. Har Narain Singh**¹⁰ where the conclusion was that Surety stands liable for the entirety of the amount the Principal Debtor is liable for. This can be well expressed through **Section 128** of the Indian Contract Act which states- *“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.”*¹¹

This means that unless the contract specifies otherwise, the Surety's liability extends along with the Principal Debtor's. Surety has no right to prevent the execution of the decree against him until the creditor has used all available remedies against the major debtor, and the creditor is entitled to seek a decree against both the surety and the principal debtor. This was very well explained in the case of **Ram Krishan v. State of Uttar Pradesh**¹².

The case of **Narsappa Nikade v. Narshiv Shripat** proves that even in cases where the debt is that of a minor, the surety stands liable as a Principal Debtor¹³. Not only does Section 128 point toward the Surety role as a Principal Debtor but Section 141 does the same too.

SURETY AS AN INDEMNIFIED

The Indian Contract Act, under **Section, 145** identifies the role of an *“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*

⁸Indian Contract Act, 1872, § 127.

⁹ SBI v. Kusum Vallabhdas Thakkar, (1994) 1 Guj LR 655.

¹⁰ Maharaja of Benaras v. Har Narain Singh, ILR (1906-07) 28 AII 25.

¹¹ Indian Contract Act, 1872, § 128.

¹² Ram Krishan v. State of Uttar Pradesh, AIR 2012 SC 2288.

¹³ Narsappa Nikade v. Narshiv Shripat, ILR (1895) 19 BOM 697.

whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully."¹⁴

To indemnify is the legal term for agreeing to compensate the other party for losses incurred as a result of the other party's performance of the promisor's act. When repaying the loan amount, the principal debtor is required by the Contract of Guarantee to reimburse the surety for any payment defaults as per the case of **Supreme Leasing v. Low Chuan Heny**¹⁵.

CREDITOR

Section 140 of the Indian Contract Act goes as follows - "*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.*"¹⁶

This section provides the Right of Subrogation to the surety. Subrogation is a legal word for a Creditors ability to sue a third party who caused a loss. This is done in order to recoup the claim payment made by the Creditor to the Principal Debtor for the damage¹⁷.

Further, it is declared that only after paying or fulfilling all of his obligations will Surety get all of the rights that the Creditor has. When the Surety's liability is coextensive to that of the Principal Debtor, his right to subrogation is not less co-extensive to that of the Creditor on the satisfaction of the debt to the Creditor¹⁸. A Surety is only responsible for fulfilling obligations and making payments to the extent that the Principal debtor has fallen behind as per **C. K. Aboobacker v. K. P. Ayishu**¹⁹.

Though it is believed to act as an advantage for a Surety, it may not always be true. The case of the **Bank of Bihar Ltd v. Damodar Prasad** expresses that when the Creditor is requested

¹⁴Indian Contract Act, 1872, § 145.

¹⁵Supreme Leasing v. Low Chuan Heny, 1989 Current LJ 809.

¹⁶ Indian Contract Act, 1872, § 140.

¹⁷Legal Information Institute, Cornell Law School,

<https://www.law.cornell.edu/wex/subrogation#:~:text=When%20one%20party%20takes%20on,substituting%20one%20creditor%20for%20another>. (April 23, 2023)

¹⁸Babu Rao Ramchandra Rao v. Babu Manaklal Nehmal, AIR 1938 Nag 413.

¹⁹ C. K. Aboobacker v. K. P. Ayishu, AIR 2000 Ker 29 (NOC).

to delay using his remedies against the Surety, the very purpose of the guarantee is compromised²⁰.

Section 141 of the Indian Contract Act emphasizes the Surety's right in the security contained in the guarantee contract. It implies that if the surety is paying the loan amount and the Principal Debtor defaults on making the payment, the Surety will be able to take advantage of security in this situation. The actual words as per the Act are as follows - "*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.*"²¹

It also gives recognition to the general Equity Rule as applied in the case of **Craythorne v. Swinburn**²². This case highlighted the fact that the Surety deserves all the remedies that the Creditor possesses against the Principal Debtor. This is due to the fact that when the Surety pays off all the debt he owes to the Creditor, he steps into the Creditor's shoes²³.

The case of **Forbes v. Jackson** also states that the right of the Surety does not get hampered even when security is burdened with further advances²⁴. Apart from this, a Creditor under no circumstances can lose or part with the security without consulting the Surety according to the case of **Industrial Finance Corporation of India Ltd v. Cannanore Spinning and Weaving Mills**²⁵.

ROLE AS CO-SURETY

Section 144 gives importance to the role of co-surety. This Section goes as follows-

"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

²⁰Bank of Bihar Ltd v. Damodar Prasad, AIR 1969 SC 297.

²¹Indian Contract Act, 1872, § 141.

²² Craythorne v. Swinburn, (1803) 14 Ves Jun 160.

²³State of M.P. v. Kaluram, AIR 1967 SC 1105.

²⁴Forbes v. Jackson, (1882) LR 19 Ch D 615.

²⁵Industrial Finance Corporation of India Ltd v. Cannanore Spinning and Weaving Mills, (2002) 5 SCC 54.

person has joined in it as co-surety, the guarantee is not valid if that other person does not join.”²⁶

It implies that in a contract where a Surety requires another person to join in order for co-surety then without the other Co-Sureties entering into a contract of guarantee, the agreement cannot be enforced. The term Co-Surety means more than one surety is responsible for the obligation²⁷.

“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.”²⁸

The above-stated is **Section 138** of the Indian Contract Act. This implies that Co-Sureties are obligated to contribute as agreed towards the repayment of the guaranteed debt when the repayment of the principal debt of the Principal Debtor is guaranteed by more than one person. The release of one of the Co-Sureties by its creditor does not release the other Co-Sureties or the released Surety from his obligation to the other sureties²⁹.

The Co-Surety sureties performing the contract are therefore entitled to claim contribution from the remaining Co-Sureties when the payment of a debt or performance of a duty is guaranteed by Co-Sureties and the Principal Debtor has defaulted in fulfilling his obligation, forcing the creditor to require only one or more of the Co-Sureties to perform the entire contract.

The following are the words of **Section 146** which imply that the co-sureties are required to contribute equally unless there is a contract that states otherwise.

“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

²⁶Indian Contract Act, 1872, § 144.

²⁷Merriam-Webster Dictionary, <https://www.youtube.com/watch?v=FsfeQK2J-8k>. (April 23, 2023)

²⁸Indian Contract Act, 1872, § 138.

²⁹ Sri Chand v. Jagdish Prashad Kishan Chand, AIR 1966 SC 1427.

equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor.”³⁰

This rule will hold true whether Co-Sureties are liable jointly or separately, whether they are bound by the same contract or a different one, and whether they are aware of one another or not.

An illustrative example of the same would be: There is a contract between A, B, and C that states that A is accountable for one-fourth of the debt, B for one-quarter, and C for one-half. A, B, and C are sureties to D for the loan of 1,000 rupees to E. E is in payment default. A, B, and C are each required to pay 250, 250, and 500 rupees, respectively, as sureties.

Section 147 of the Indian Contract Act is worded as follows-“*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*”³¹

It means Co-Sureties are required to contribute equally up to the maximum of the amount each has committed to guarantee where they have agreed to guarantee differing amounts. The case of **SBI v. Prem Dass** also gives the meaning of the section i.e., when there are multiple sureties for a debt and the principal debtor defaults, each surety is responsible for contributing equally to the default's extent³². But in case either of the Sureties happens to pay a heftier part of the share, then the Co-Surety must pay to the other Surety to equalize it³³.

An illustrative example of the same would be: In three different bonds, A, B, and C are sureties for D. A was penalized Rs. 10,000, B was fined Rs. 20,000, and C was fined Rs. 40,000. D makes a default payment of Rs. 40,000. As a result, A is responsible for \$10,000, B is liable for \$15,000, and C is likewise liable for \$15,000 in damages.

CONCLUSION

As mentioned previously, the role of a Surety is quite like the character of Dr. Jekyll. Various roles are taken up by a person who chooses to be a Surety such as Principal Debtor, Creditor, Co-Surety, and Indemnifier. But in the process of it, one must remember the essentials of a Contract of Guarantee which are as follows-

³⁰Indian Contract Act, 1872, § 146.

³¹Indian Contract Act, 1872, § 147.

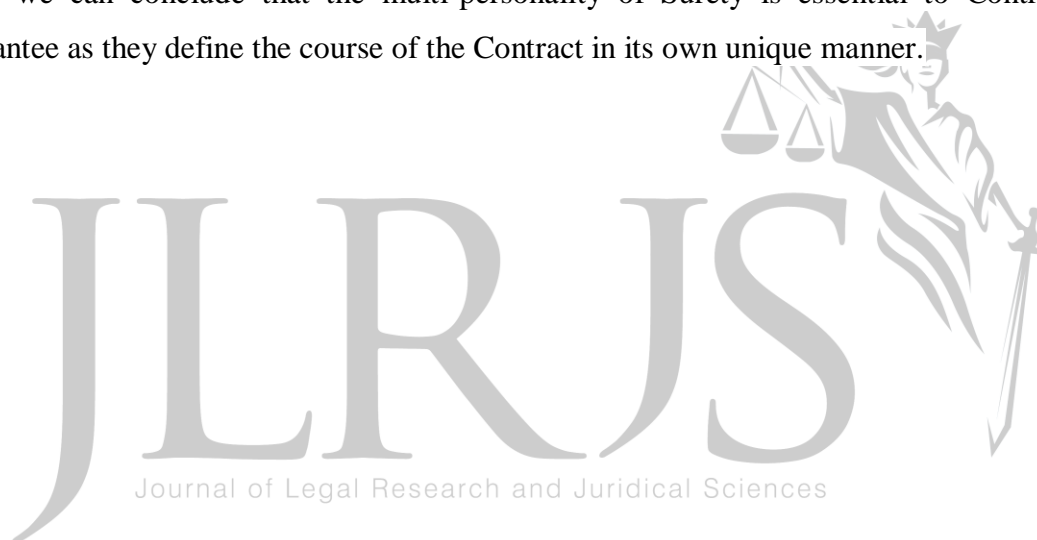
³² SBI v. Prem Dass, AIR 1998 Del 49.

³³ Shirley v. Burdett, (1911) 2 Ch 418.

- Existence of principal debt³⁴.
- Consideration for a contract of guarantee³⁵.
- No form of misrepresentation or concealment³⁶.
- The contract's essential elements must be present.
- The contract of guarantee is a wholly separate contract.

Apart from this, the role of a Principal Debtor and Creditor must also be taken into consideration as a Surety holds no value without either of the two characters or a proper valid Contract of Guarantee. With respect to this, it is important to understand how each of the parts played by Surety has an impact on his own life. The various faces of a Surety sometime lead to Profit or Loss for the Surety and affect him so.

Thus, we can conclude that the multi-personality of Surety is essential to Contracts of Guarantee as they define the course of the Contract in its own unique manner.



³⁴Swan v. Bank of Scotland, (1836) 10 Bligh NS 627.

³⁵Indian Contract Act, 1872, § 127.

³⁶Shriniwas Shankar Potnis v. Raghukul Sahakari Griharachana Sanstha Maryadit, (2010) 1 Mah LJ 368.