Contract of Guarantee.

(Sec 126-147)

A Contract to perform the promise, or discharge the liability, of a third person in case of his default is called Contract of Guarantee. A guarantee may be either oral or written.

1. The person who gives the guarantee is called the Surety
2. The person on whose default the guarantee is given is called the Principal Debtor
3. The person to whom the guarantee is given is called the Creditor.

Illustration: If A gives an undertaking stating that if ` 300 are lent to C by B and C does not pay, A will pay back the money, it will be a contract of guarantee. Here, A is the surety, B is the principal debtor and C is the creditor. Surety is the person gives the guarantee, the Principal Debtor is one for whom the guarantee is given and the creditor is the person to whom the guarantee is given.

Contract Act uses the word 'surety' which is same as 'guarantor' Prima facie, the surety is not undertaking to perform should the principal debtor fail; the surety is undertaking to see that the principal debtor does perform his part of the bargain

ESSENTIALS OF CONTRACT OF GUARANTEE

1. Contract of Guarantee if a species of a contract, the general principles governing contracts are applicable here. There must be free consent, a legal objective to the contract, etc. Though all the parties must be capable of entering into a contract, the principal debtor may be a party incompetent to contract, ie., a minor. This scenario is discussed later in this chapter.

2. A principal debt must pre-exist: A contact of gurantee seeks to secure payment of a debt, thus it is necessary there is a recoverable debt. There can not be a contract to guarantee a time barred debt.

3. Consideration received by the principal debtor is sufficient for the surety. Anything done, or any promise made for the benefit of the principal debtor can be taken as sufficient consideration to the surety for giving guarantee.

In the case of **Birkmyrvs Darnell 1704**, where the court held that when two persons come to a shop, one person buys, and to give him credit, the other person promises, "If he does not pay, I will", this type of a collateral undertaking to be liable for the default of another is called a contract of guarantee".

In the case of **Swan vs Bank of Scotland 1836**, it was held that a contract of guarantee is a tripartite agreement between the creditor, the principal debtor, and the surety

1. Distinct promise of surety - There must be a distinct promise by the surety to be answerable for the liability of the Principal Debtor.

2. Liability must be legally enforceable - Only if the liability of the principal debtor is legally enforceable, the surety can be made liable. For example, a surety cannot be made liable for a debt barred by statute of limitation.

3. Consideration - As with any valid contract, the contract of guarantee also must have a consideration. The consideration in such contract is nothing but anything done or the promise to do something for the benefit of the principal debtor.

Section 127 clarifies this as follows:

"Anything done or any promise made for the benefit of the principal debtor may be sufficient consideration to the surety for giving the guarantee."

Illustrations:

1. A agrees to sell to B certain goods if C guarantees the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promise to deliver goods to B. This is a sufficient consideration for C's promise.

2. A sells and delivers goods to B. C, afterwards, requests A to forbear to sue B for an year and promises that if A does so, he will guarantee the payment if B does not pay. A forbears to sue B for one year. This is sufficient consideration for C's guarantee.

3. A sells and delivers goods to B. Later on, C, without any consideration, promises to pay A if B fails to pay. The agreement is void for lack of consideration.

It is pertinent to note that there is no uniformity on the issue of past consideration. In the case of **Allahabad Bank vs S M Engineering Industries 1992** Cal HC, the bank was not allowed to sue the surety in absence of any advance payment made after the date of guarantee. But in the case of **Union Bank of India vs A P Bhonsle 1991**Mah HC, past debts were also held to be recoverable under the wide language of this section. In general, if the principal debtor is benefitted as a result of the guarantee, it is sufficient consideration for the sustenance of the guarantee. It should be without misrepresentation or concealment –

Section 142 specifies that a guarantee obtained by misrepresenting facts that are material to the agreement is invalid, and section 143 specifies that a guarantee obtained by concealing a material fact is invalid as well.

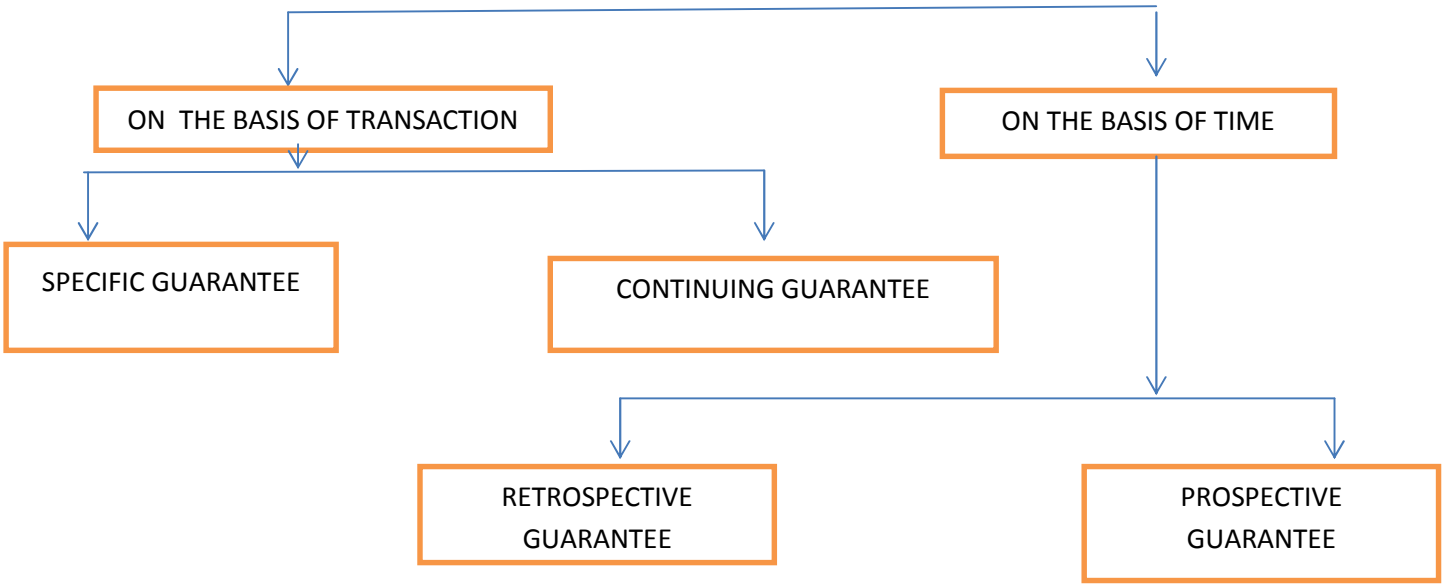
Illustrations: -

1. A appoints B for collecting bills. B fails to account for some of the bills. A asks B to get a guarantor for further employment. C guarantees B's conduct but C is not made aware of B previous mis-accounting by A. B, afterwards, defaults. C cannot be held liable.

2. A promises to sell Iron to B if C guarantees payment. C guarantees payment however, C is not made aware of the fact that A and B had contracted that B will pay 5 Rs higher that the market prices. B defaults. C cannot be held liable.

In the case of **London General Omnibus vs Holloway 1912**, a person was invited to guarantee an employee, who was previously dismissed for dishonesty by the same employer. This fact was not told to the surety. Later on, the employee embezzled funds but the surety was not held liable.

Type of Guarantee:



Continuing Guarantee:

As per section 129, a guarantee which extends to a series of transactions is called a continuing guarantee.

Illustrations –

1. A, in consideration that B will employ C for the collection of rents of B's zamindari, promises B to be responsible to the amount of 5000/- for due collection and payment by C of those rents. This is a continuing guarantee.

2. A guarantees payment to B, a tea-dealer, for any tea that C may buy from him from time to time to the amount of Rs 100. Afterwards, B supplies C tea for the amount of 200/- and C fails to pay. A's guarantee is a continuing guarantee and so A is liable for Rs 100.

3. A guarantees payment to B for 5 sacks of rice to be delivered by B to C over the period of one month. B delivers 5 sacks to C and C pays for it. Later on B delivers 4 more sacks but C fails to pay. A's guarantee is not a continuing guarantee and so he is not liable to pay for the 4 sacks. Thus, it can be seen that a continuing guarantee is given to allow multiple transactions without having to create a new guarantee for each transaction.

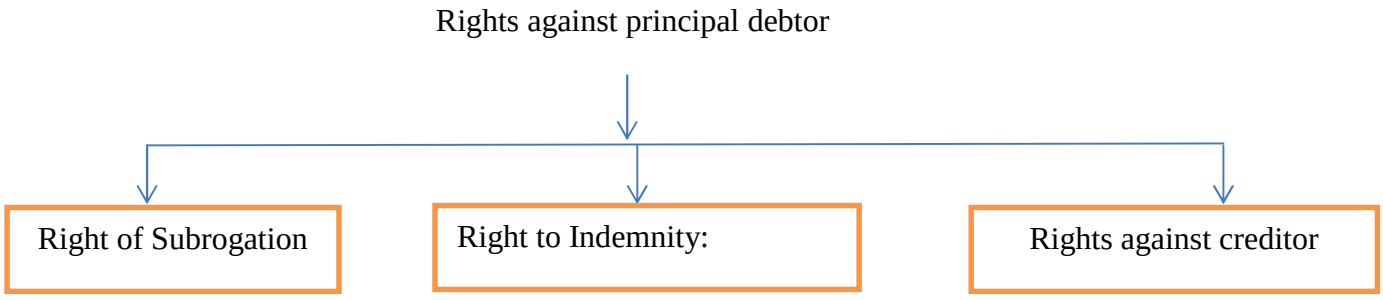
In the case of **Nottingham Hide Co vsBottrill 1873**, it was held that the facts, circumstances, and intention of each case has to be looked into for determining if it is a case of continuing guarantee or not.

Revocation of Continuing Guarantee:

As per section 130, a continuing guarantee can be revoked at any time by the surety by notice to the creditor.

Rights of the Surety

A contract of guarantee being a contract, all rights that are available to the parties of a contract are available to a surety as well. The following are the rights specific to a contract of guarantee that are available to the surety.



1. Right to securities: As per 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 about 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

The SC in the case of **State of MP vsKaluram AIR 1967**. In this case, the state had sold a lot of felled trees for a fixed price in four equal instalments, the payment of which was guaranteed by the defendant. The contract further provided that if a default was made in the payment of an instalment, the State would get the right to prevent further removal of timber and the sell the timber for the realization of the price. The buyer defaulted but the State still did not stop him from removing further timber. The surety was then sued for the loss but he was not held liable. It is important to note that the right to securities arises only after the creditor is paid in full. If the surety has guaranteed only part of the debt, he cannot claim a proportional part of the securities after paying part of the debt. This was held in the case of **Goverdhan Das vs Bank of Bengal 1891.**

2. Right of set off.

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Rights against co-sureties.

1. Effect of releasing a surety (section 138)

2. Right to contribution: (section 146)

As per section 147, co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit. Illustrations – 1. A, B and C as sureties to D, enter into three several bonds, each in different penalty, namely A for 10000Rs, B for 20000 Rs, and C for 30000Rs with E. D makes a default on 30000Rs. All of them are liable for 10000Rs each.

2. A, B and C as sureties to D, enter into three several bonds, each in different penalty, namely A for 10000Rs, B for 20000 Rs, and C for 40000Rs with E. D makes a default on 40000Rs. A is liable for 10000Rs while B and C are liable for 15000Rs each..

3. A, B and C as sureties to D, enter into three several bonds, each in different penalty, namely A for 10000Rs, B for 20000 Rs, and C for 40000Rs with E. D makes a default on 70000Rs. A, B and C are liable for the full amount of their bonds.

Discharge of Surety from Liability:

A surety is said to be discharged from liability when his liability comes to an end. Indian Contract Act 1872 specifies the following conditions in which a surety is discharged of his liability –

1. Section 130 - By a notice of revocation

2. Section 131 - By death of surety

3. Section 133 - By variance in terms of

4. Section 134 - By discharge of principal debtor

5. Section 135 - By composition, extension of time, or promise not to sue

Extent of Surety's Liability:

As per section 128, the liability of a surety is co-extensive with that of the principal debtor, unless it is otherwise provided in the contract.

Important

- . There are three parties in every Contract of Guarantee
- The liability arises right from the beginning.

- The surety becomes liable when the principle debtor commits default in meeting the liability.
- Surety has the right to sue the third party (Principle Debtor) directly. The Law puts him in the position of Creditor. Where as in Contracts of Indemnity, the Indemnifier cannot sue the third party in his name. He has to sue in the name of the Indemnity-holder or after obtaining the rights from him.
- 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. The guarantor need not personally derive any benefit from the guarantee.
- The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract.
- The creditor can straightway proceed against the guarantor without first proceeding against the principal debtor.
- The liability of the surety can never be greater than that of the principal debtor. The surety can however may restrict his liability to part of the Principal debtor's liability by contract.
- Surety's liability is distinct and separate.