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SURETY'S LIABILITY UNDER INDIAN CONTRACT ACT, 1872 AND ENFORCEABILITY OF RIGHTS AGAINST THE LEGAL HEIRS AFTER SURETY'S DEATH

ABSTRACT

In our day-to-day life transactions, the human world comes into various kinds of contractual agreements with the like, in day-to-day life. Be it expressed or implied, verbal or written, we humans roll into various such propositions in regular life - some agreements however, need an additional assurance to ensure that the parties to the contract meet out the terms and conditions of the bond, even in case of a default. Thus, to ensure that no miscarriage of the bond occurs, in case of an unfortunate incapability of performance by the party to the contract, the performer ensures a surety. Such a surety is often given by a third party or person known as the guarantor or surety holder – who makes a legal promise to take upon him the liability of the contract upon non-performance. A contract thus signed is called a Contract of Guarantee.

Through this paper we shall explore and research the scope, the nature and the extent of the same.

KEYWORDS

Contract of guarantee, continuing guarantee, principal debtor, creditor, surety, liability, revocation, discharge of liability, performance.

INTRODUCTION

A Guarantee is an underwriting to answer for another's liability and collateral thereto, to take the responsibility for the debt, default or miscarriage of another.

The person who gives the guarantee is called the 'surety' and in respect of the person of whose default the debt is given is called the 'principal debtor' and the person to whom guarantee is given is called the 'creditor'.

The contract of guarantee ensures that a person can procure a loan, a credit, goods or even employment. The person in need of the debt comes to the lender or creditor and asks for the loan or debt and that in case of a default or miscarriage in repaying of the debt, a third person ensures that he / she will repay the debt on the principal debtor's behalf and thus takes the responsibility.

This kind of a collateral undertaking is called a 'Contract of Guarantee'.

In the context of Indian Law and English Law the word surety and guarantee are used interchangeably.

'Section 128 of the Indian Contract Act, 1872, deals with Surety's Liability'.

- *"A surety's liability is co-extensive with that of the principal-debtor, unless the contract of guarantee provides otherwise."*

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RESEARCH QUESTION

1. Can rights of a legal heir be upheld after the death of Surety?

FEATURES OF GUARENTEE

There are a few requisites for a valid Contract of Guarantee.

They are as follows:

1. Principal debt given to the principal debtor
2. Consideration
3. A surety giver or a guarantor
4. Guarantee given by free consent

The Essentials of a Guarantee Contract are:

- Tripartite Agreement: A contract of guarantee has 3 parties - the principal debtor, the creditor, and the surety. In order for a contract of guarantee to be successful, there must be three different contracts between the three parties, each of which must be consenting.
- Liability: The principal debtor bears the major responsibility. The surety is responsible for secondary liability, which can only be invoked if the principal debtor fails to pay.
- Essentials of a Valid Contract: It preserves free consent, consideration, lawful object, and contracting parties' competency as essentials of a valid contract, just like every other general contract.
- Medium of Contract: The Indian Contract Act, 1872, does not expressly state that any written form of guarantee contract is required. It will be appropriate in both oral and written form.

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NATURE AND EXTENT OF SURETY'S LIABILITY

1. CO EXTENSIVE WITH THE PRINCIPAL DEBTOR –

Section 128 of the “*Indian Contract Act*” says that a surety’s liability is only coextensive with that of the principal debtor unless specified or otherwise provided in the contract.

The phrase “*coextensive with that of the principal debtor*” indicates maximum extension of the surety’s liability.

A guarantor is liable only to repay as much as the credit taken by the principal debtor and the guarantor will be liable to pay as long as the principal debtor is liable to pay the debt. If the principal debtor is discharged from his liability – as in case of a time bar debt, the guarantor’s liability is also dismissed.

Also the surety is also liable not only for the principal amount but the interest on the principal money too and on the charges incurred on enforcing the liability.¹

The only illustration appended to the section says that if a surety lies on a loan bond, then the liability to pay not only extends to the principal money but also to the interest and the charges which may have come additionally due on it.²

ILLUSTRATION –

A guaranteed B. the payment of rent due from B. to C., but B. did not pay the rent. On a true construction of the contract, A was only responsible for the rent, not for interest on the rent, unless the bond included terms like "with interest thereon."

A surety who had promised the plaintiff's supply of pure quality mustard oil as a commission agent was a surety for the assurance of supply of that quality oil, and his liability under this provision would be co-extensive with the manufacturer's.

In contrast, if the surety had promised that the principal-debtor, a ship charterer, would pay income tax, the surety was not liable when the principal-debtor was found not liable to pay income tax.

1. “*Maharaja of Benaras v Har Narayan Singh, ILR (1906 -07)*”
2. “*Nandlal Chogalal v Surajmal Gangaram, AIR 1932*”

2. SURETY’S RIGHT TO LIMIT HIS LIABILITY OR MAKE IT CONDITIONAL

It is up to the open discretion of the surety whether they want to limit their responsibility as a guarantor and bear only part of the liability. For e.g. - If A being the principal debtor takes a loan of \$2000 from B and ensures C is the surety, then in that case C will be free to consent to bear only \$1000 as surety in case of a default or miscarriage. The rest liability lies on the principal debtor and the specific performance of the same will be exclusively his purview.



FACTORS AFFECTING A CONTRACT OF GUARENTEE

COMMENCEMENT OF LIABILITY

The commencement of the surety's liability is determined by the terms of the contract of guarantee and it pivots on the construction of terms of the bond; however, the parties can agree, that the surety's liability may arise only in a specific contingency.

If the principal-debtor defaults, causing a loss to the creditor, the surety is automatically held liable to the full extent of his liability as mentioned in the bond, unless the terms of the guarantee state otherwise. If the terms of the guarantee warrant it, he is not entitled to any notice of the default.

When the guarantee stipulates that a ‘judgement’ or ‘award’ against the principal debtor is binding on the guarantor, liability cannot be avoided, claiming that the guarantor was not a party to the ‘creditor and principal debtor's arrangement’ on the basis of which the court issued an award.

CONDITION PRECEDENT

If there lies a condition which is precedent to the surety’s liability, the guarantor will not be liable unless the condition is fulfilled first. However, there is a partial recognition of the principal in “*Section 144*” of the Act.

“When a person gives a guarantee upon a contract 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”.

In “*National Provincial Bank of England v Brackenbury*”³ The defendant was inclined to sign a joint guarantee with several persons, where one of the guarantor did not sign. There was no further argument on the matter and he was held not liable – “*as there is no contract of guarantee unless all parties to the contract were bound*”

3. “*Maharaja of Benaras v Har Narayan Singh, ILR (1906 -07)*”

Where the liability can be said to be otherwise unconditional in nature, the court cannot introduce its own condition to it. ⁴

GUARENTEE OF PERFORMANCE

A contract for due performance does not replace the right to sue for damages. The creditor has the right to make a call to seek remuneration for the full value of the bond, even if the default caused no pecuniary loss to the creditor in numbers. The sheer lapse on the debtor’s part is enough to seek for damages and the surety has to meet out the same.

An illustration goes in which the defendant guaranteed a bank loan. Having had a default, the defendant was sued where the trial court held that the bank shall enforce the surety only after exhausting all remedies against the principal debtor. This happened in the case of “*Bank of Bihar Ltd v Damodar Prasad*”. The Supreme Court overruled it stating that the very purpose of a guarantee is nullified if the creditor is to postpone his remedies against surety. Before the payment is complete the guarantor has no right to dictate terms to the creditor in the first instance.

LIABILITY FOR PAST TRANSACTIONS

Unless there is an existing formal arrangement otherwise, a surety is not responsible for any liability incurred by the principal-debtor, prior to the acceptance of the contract of surety – that is - document of suretyship. If in case, a company's directors assumed the roles of sureties after they became directors, their liability would be exclusively limited to the borrowings or outstanding(s) existing after they became sureties, rather than being burdened by prior liabilities, unless explicitly mentioned in a contract otherwise.

ACTION AGAINST PRINCIPAL DEBTOR ALONE

The creditor can file a suit against the principal debtor by alone, without joining the surety in the liable to the suit as the principal debtor is the primary party to the contract and the suit cannot be dismissed on any grounds.⁵

SUIT AGAINST SURETY

A lawsuit against the surety can be held maintainable without impleading the principal debtor. This makes the sureties especially vulnerable and the court may also rescue the guarantee which was hence prevailed upon.⁶

4. *“Bank of Bihar Ltd v Damodar Prasad”*
5. *“Union Bank of India v Noor Diary Farms. (1997) 3 Bom CR 126”*
6. *“Vijay Singh Padode v Sicom Ltd”*

PROCEEDING AGAINST THE SURETY’S MORTGAGED PROPERTY

No financial company shall possess the guarantor's mortgaged property without notifying the guarantor in advance. Without the consent of the guarantor, even the public auction of the guarantor's property cannot be carried out, because the guarantor is not the main party to the contract. He is only bound only secondarily, through a contract of guarantee – that is - with the primary debtor's secondary bonds, and only the principal debtor has the primary responsibility of the contract.⁷

AGREEMENT TO BE BOUND BY ANY ACKNOWLEDGEMENT, ETC BY PRINCIPAL DEBTOR ABOUT INDEBTEDNESS

The sureties which were agreed upon in the contract or the deed, which in the first place led them to be bound by any acknowledgement, admission, or part payment of the borrower, shall hold the guarantor liable for payment in case of default and the surety can in no way disembark themselves of the liability.⁸

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PROSECUTION OF SURETY FOR BOUNCING OF CHEQUE

Under the *“Negotiable Instruments Act, (Section 138)”* a suit can be proceeded against the surety if his cheque bounces during the repayment of the principal debtor’s debt. Discharge of personal liability cannot be assumed as a defence as the performance of his contract (of guarantee) shall be deemed incomplete unless that transaction / performance on his end is duly completed.

DEATH OF PRINCIPAL DEBTOR

In case of the death of the principal debtor, a law suit could be brought into action against the surety, as the liability to satisfy the contract now shrouds on him - in case of incomplete performance of the contract.

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7. *“Amulya Lal Chaudhury v Tripathi Industrial Development Corporation Ltd”*
 8. *“P. Jagadeshwar Reddy v Bank of Maharashtra”*

DISCHARGE OF SURETY’S LIABILITY

An ordinary guarantee cannot be revoked once it is accepted upon. However, the **Section 130** of this act gives the provision for the discharge of liability from continuing guarantee.

Section 129 of *“Indian Contract Act, 1872”* defines 'Continuing Guarantee' as *“A guarantee which extends to a series of transaction, is called, a “continuing guarantee”*.

Section 130 defines – *“Continuing guarantee can be revoked by notice, by death of the surety and by variance in the terms of the contract between debtor and creditor.”*

Continuing guarantee can be revoked by the following procedures-

- a) By notice,
- b) by death of the surety, and,
- c) by variance in the terms of the contract between debtor and creditor.

Section 131 of the Indian Contract Act 1872 speaks of **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”*

Thus factors which discharge surety from liability are as follows-

- 1) By revocation of continuing guarantee
- 2) Variance in the terms of the contract
- 3) Surety’s death
- 4) Loss of security

- 5) Opening a new account in place of an old one
- 6) Time barred contract
- 7) Discharge of principle debtor itself

Can rights of a legal heir be upheld after the death of Surety?

In a continuing guarantee, when surety dies, the deceased surety's liability towards the creditor is henceforth bound only till the transactions which had taken place during the lifetime of the surety. All transactions that were supposed to be performed after the death of the surety remain terminated.

The legal heirs/representatives are only liable to mitigate the duties or promises, accepted to, by the creditor, but they are not liable for any future transactions that the deceased creditor priory thought of executing, unless such liability on the legal heir is expressly mentioned in the contract. Nevertheless, in terms of **Section 130 of the Indian Contract Act, 1872**, a continuing guarantee may, at any time, be revoked by the surety (including legal representatives of the deceased) as to future transactions by notice to the creditor.

RELEVANT CASE LAW

Kamal Gupta vs Bank of India (AIR 2008 Delhi 51)

Facts show that the case involved a loan obtained by ROM Industries Limited from the defendant - Bank of India - for the issuance of an import letter of credit. 650 Lux. An Smt. Parvati Devi and others are the guarantee of the above-mentioned financial assistance. She allegedly also created a fair mortgage for her real estate. In October 1996, the assets of ROM Industries Ltd were declared non performing (NPA) by the Bank of India. On August 19, 2000 Smt. Parvati Devi has passed away. In November 2003, the Bank of India filed a recovery application with the debt recovery court for the loan mentioned above. Although, Smt. Parvati Devi has passed away before filing date of the above application, she was still recognised as a designated as a party to the recovery. She was still the guarantor. Subsequently, an amendment was requested to prosecute her legal representatives, including her son Girdhari Lal Gupta and her daughter Asha Singla. The aforementioned Girdhari Lal Gupta also died on May 2, 2004 and his legal representatives, including Kamal Gupta and Rajan Gupta, were replaced. The sayings Kamal Gupta and Rajan Gupta are the sons of the late Shri Girdhari Lal Gupta.

Therefore, the lawsuit was brought by Asha Singla, Kamal Gupta and Rajan Gupta, all of whom were direct or indirect legal representatives of Late Smt. Parvati Devi.

The trial court and the high court both dismissed the petitions and held the legal heirs were indeed bound by all statutory definitions as liable as surety as substituting guarantors after the death of Smt. Parvati Devi. Therefore, the court said that the death of Smt. Parvati Devi by itself would not amount to a revocation of the guarantee in question. In any event, Section 131 makes it clear that the death of a surety would operate

as a revocation only as regards future transactions. The liability in respect of past transactions would however remain.

ANALYSIS:

This quite rightly exhibits how the legal heir of Surety is held as liable to pay the debt of a continuing guarantee after the demise of the guarantor. The legal heirs/representatives are only liable to mitigate the duties or promises, accepted to, by the principal debtor before their demise, however they are not liable for any future transactions, unless such liability on the legal heir is expressly mentioned in the contract.



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