

CA Foundation

Paper 2 - Business Law

Chapter 2 - ICA

The Indian Contract Act, 1872

Notes by - CA Chaitanya Jain

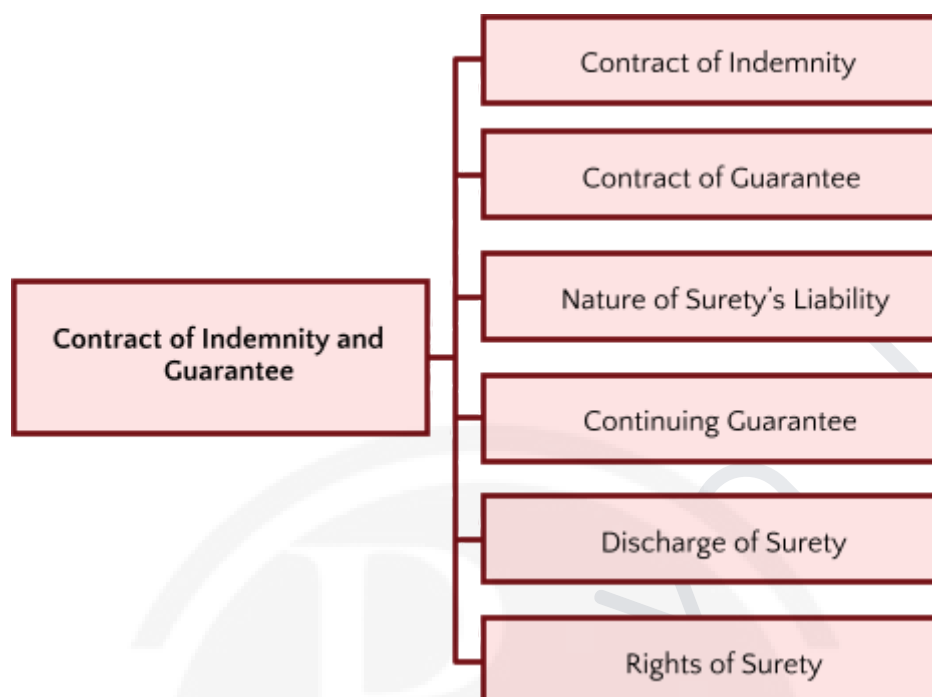
The Indian Contract Act, 1872

Unit 7 - Contract of Indemnity & Guarantee

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Unit 7 - Contract of Indemnity & Guarantee



Sections 124 to 147 of the Indian Contract Act, 1872.

CONTRACT OF INDEMNITY

Indemnity

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

124 - Contract of Indemnity

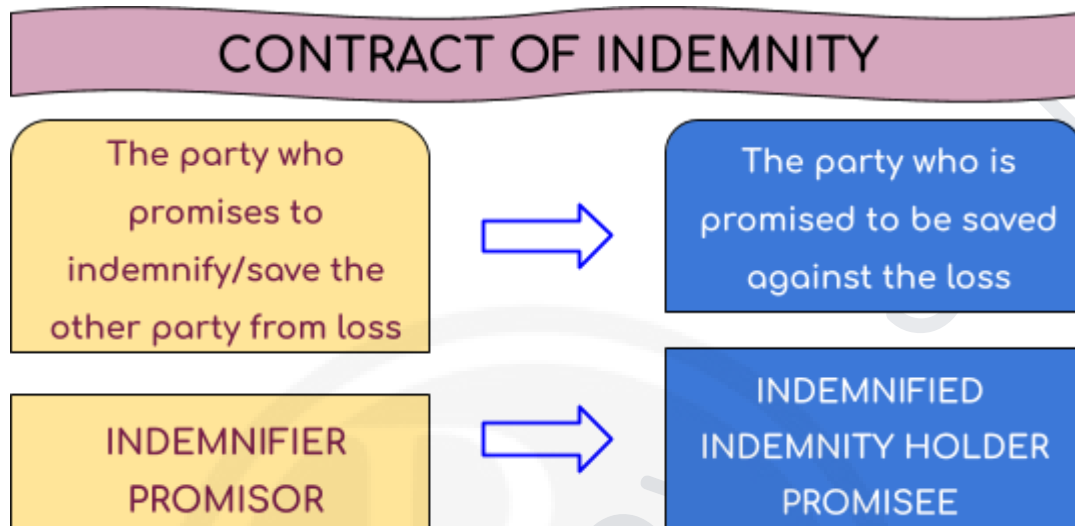
- It is a contract by which one party PROMISES to save the other from LOSS caused to him -
- LOSS HOW ?? - By the conduct of the promisor himself or by the conduct of any other person."

Example 1: Mr. X contracts with the Government to return to India after completing his studies (which were funded by the Government) at University of Cambridge and to serve the Government for a period of 5

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years. If Mr. X fails to return to India, he will have to reimburse the Government. It is a contract of indemnity.

Parties:



Example 2: 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 3: X may agree to indemnify Y for any loss or damage that may occur if a tree on Y's neighboring 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.

Thus - Contract of Indemnity - Restricts the loss caused by :

- (i) the conduct of the promisor himself, or
- (ii) the conduct of any other person.

Contract of Indemnity & Bailment ◀ 2.7

(Not covered) Loss by -
An accident not caused by any person or
Act of God/ natural event

Gajanan Moreshwar v/s Moreshwar Madan (1942),

Decision is taken on the basis of English Law.

As per English Law -

Indemnity means promise to save another harmless from the loss. Here it covers every loss whether due to negligence of promisee or by natural calamity or by accident.

Mode of contract of indemnity:

- Express or Implied.
 1. Expressed when a person expressly promises to compensate the other from loss.
 2. Implied when it is to be inferred from the conduct of the parties or from the circumstances of the case.
- A contract of indemnity is like any other contract and must fulfil all the essentials of a valid contract.

Example 4: 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 Rs. 1000, B cannot claim this amount from A because the object of the agreement is unlawful.

Contract of Indemnity -
Life Insurance - NO
Fire Insurance - YES

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Marine Insurance - YES

125 - Rights of Indemnity-holder when sued

- The promisee
- acting within the scope of his authority,
- is entitled to recover from the promisor/indemnifier—
 - a. all damages which he may be compelled to pay in any suit
 - b. all costs which he may have been compelled to pay in bringing/defending the suit and
 - c. All sums which he may have paid under the terms of any compromise of suit.

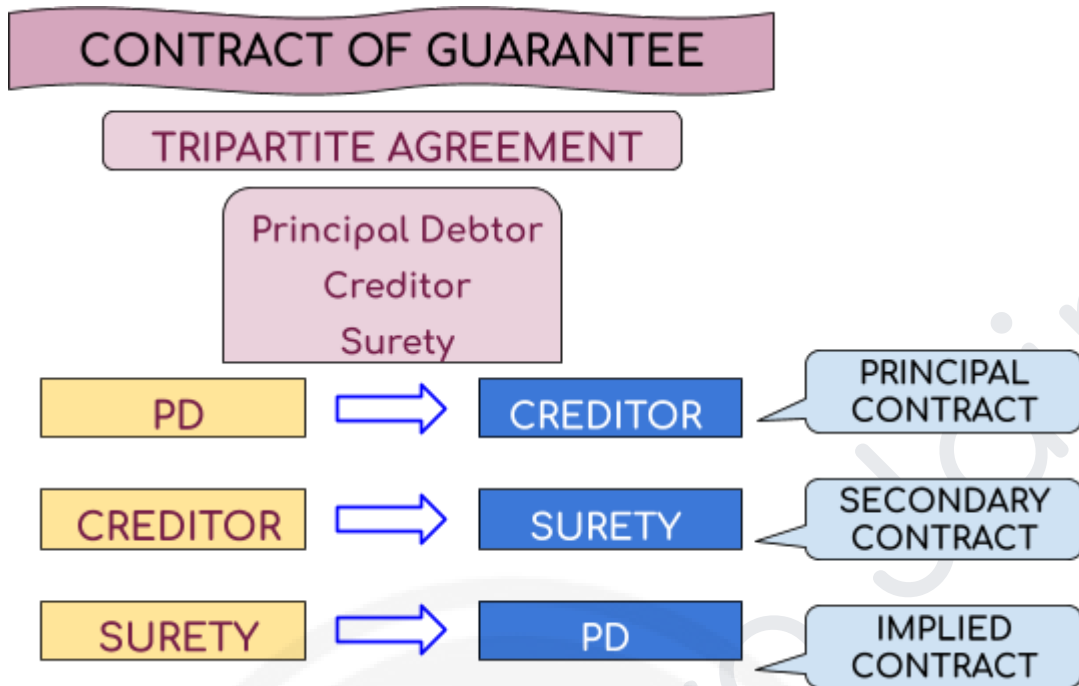
When does the liability of an indemnifier commence?

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

CONTRACT OF GUARANTEE

126 - Contract of Guarantee - Surety, Principal Debtor and Creditor



Contract of guarantee:

- 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**.

Example 6: 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 failing 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 7: X and Y go into a car showroom where X says to the dealer to supply the latest model of Wagon R to Y, and agrees that if Y fails to pay he will. In case of Y's failure to pay, the car showroom will recover its money from X.

This is a contract of guarantee because X promises to discharge the liability of Y in case of his defaults.

The right of surety is not affected by the fact that -

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The creditor has refused to sue the principal debtor or that he has not demanded the sum due from him

ESSENTIAL FEATURES OF A GUARANTEE

The following are the requisites of a valid guarantee :-

Requisite	Explanation
Purpose	A guarantee is to secure payment of a recoverable debt. No principal debt means no valid guarantee.
Consideration Section 127	A guarantee must have some consideration. No direct consideration is needed between surety and creditor. Consideration given to the principal debtor is enough. However, past consideration is not valid. The surety must be competent to contract for a valid guarantee (Even if PD is incompetent)
Existence of Liability	There must be an existing liability or enforceable promise. The liability must be legally enforceable, not time-barred.
No Misrepresentation Section 142	Guarantee obtained by misrepresentation concerning a material part of the transaction is invalid.
No Concealment Section 143	Guarantee obtained by keeping silence as to material facts is invalid.
Written or Oral Section 126	A guarantee can be either oral or written; writing is not necessary.
Joining of Co-Sureties Section 144	If a guarantee is given on the condition that another person must join as a co-surety, the guarantee is not valid if that other person does not join.

All the related examples are shown here :-

Example 8: 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.

Example 9: A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

Example 10: 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.

Example 11: A guarantees to C payment for iron to be supplied by him to B to the amount of 2,000 tons. B and C have privately agreed that B should pay rupee five per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety

TYPES OF GUARANTEES

Guarantee may be classified under two categories:

Type of Guarantee	Explanation	Surety's Liability
Specific Guarantee	A guarantee that applies to a single debt or specific transaction.	Ends when the debt is discharged or the promise is performed.
Continuing Guarantee Section 129	A guarantee that applies to a series of transactions. It continues until revoked by the	Continues until the guarantee is revoked.

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Type of Guarantee	Explanation	Surety's Liability
	surety. It covers any number of transactions and makes the surety liable for the unpaid balance at the end of the guarantee.	

SPECIFIC GUARANTEE -

Example 12: 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]

CONTINUING GUARANTEE -

Example 13: On A's recommendation B, a wealthy landlord employs C as his estate manager. It was the duty of C to collect rent on 1st of every month from the tenant of B and remit the same to B before 5th of every month. A, guarantee this arrangement and promises to make good any default made by C. This is a contract of continuing guarantee.

Example 14: A guarantees payment to B, a tea-dealer, to the amount of ` 10,000, for any tea he may from time-to-time supply to C. B supplies C with tea to above the value of Rs. 10,000, and C pays B for it. Afterwards B supplies C with tea to the value of Rs. 20,000. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of Rs. 10,000.

Contract of Indemnity & Bailment ◀ 2.7

DISTINCTION BETWEEN A CONTRACT OF INDEMNITY & CONTRACT OF GUARANTEE

Point of distinction	Contract of Indemnity	Contract of Guarantee
Number of party/parties to the contract	There are only two parties namely the indemnifier [promisor] and the indemnified [promisee]	There are three parties - creditor, principal debtor and surety.
Nature of liability	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.
Time of liability	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.
Time to Act	The indemnifier need not act at the request of indemnity holder.	The surety acts at the request of principal debtor.
Right to sue third party	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.
Purpose	Reimbursement of loss	For the security of the creditor
Competency to contract	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.

SURETY'S LIABILITY

128 - NATURE AND EXTENT OF SURETY'S LIABILITY

The liability of the surety is -

1. Co-extensive with that of the principal debtor unless it is otherwise provided by the contract.
2. Secondary nature as he is liable only on default of principal debtor.
3. Where a debtor cannot be held liable on account of any defect in the

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document, the liability of the surety also ceases.

4. A creditor may choose to proceed against a surety first, unless there is an agreement to the contrary.

Example 15: 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.

132 -

LIABILITY OF TWO PERSONS,
PRIMARILY LIABLE,
NOT AFFECTED BY
ARRANGEMENT BETWEEN THEM - THAT ONE SHALL BE SURETY ON OTHER'S
DEFAULT

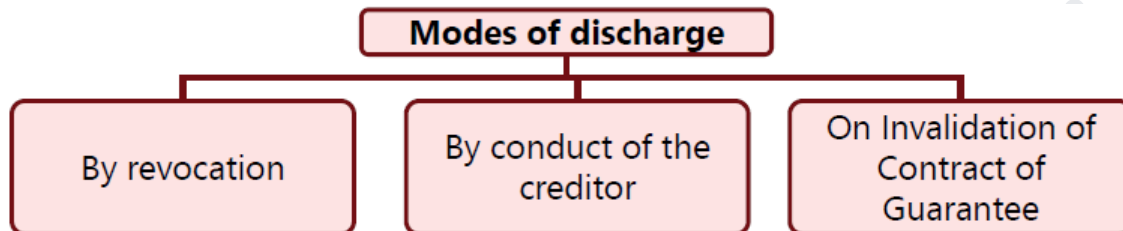
- Where two persons contract with a third person to undertake a certain liability, and
- also contract with each other that one of them shall be liable only on the default of the other,
- the third person not being a party to such contract,
- the liability of each of such two persons
- to the third person under the first contract is not affected by the existence of the second contract,
- although such a third person may have been aware of its existence.

Example 16: 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.

DISCHARGE OF A SURETY

A surety is said to be discharged -

- when his liability as surety comes to an end.
- The various modes of discharge of surety are discussed below:
 - (i) By revocation of the contract of guarantee.
 - (ii) By the conduct of the creditor, or
 - (iii) By the invalidation of the contract of guarantee.



By revocation of the contract of guarantee -

130 - CG by Notice

131 - CG by Death

62 - Novation

130 - Revocation of Continuing Guarantee by Notice

- The surety can revoke a continuing guarantee by giving notice to the creditor.
- The surety is liable for all transactions before the notice but not for future transactions.
- A specific guarantee can only be revoked if liability to the principal debtor has not accrued.

Example 17: Arun promises to pay Rama for all groceries bought by Carol for a period of 12 months if Carol fails to pay. In the next three months, Carol buys ` 2000/- worth of groceries. After 3 months, Arun revokes the guarantee by giving a notice to Rama. Carol further purchases ` 1000 of groceries. Carol fails to pay. Arun is not liable for ` 1000/- of purchase that was made after the

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notice but he is liable for ` 2000/- of purchase made before the notice.

131 - Revocation of Continuing Guarantee by Surety's death

- *In the absence of an agreement to the contrary, the surety's death revokes the continuing guarantee for future transactions.*
- *The surety's estate remains liable for transactions before the death.*
- *However, the surety's estate remains liable for the past transactions which have already taken place before the death of the surety.*

Example 18: 'S' guarantees 'C' for the transaction to be done between 'C' & 'P' for next month. After 5 days 'S' died. Now the guarantee is revoked for future transactions but 'S's estate is still liable for transactions done during the previous five days.

62 - Revocation by Novation

If a new or fresh contract replaces the old one (either between the same or different parties), the surety is discharged from the original contract.

Example 19: 'S' guarantees 'C' for the payment of the supply of wheat to be done by 'C' & 'P' for next month. After 5 days, the contract is changed. Now 'S' guarantees 'C' for the payment of the supply of rice to be done by 'C' & 'P' for the rest of next month. Here, the guarantee is revoked for the supply of wheat. But 'S' is still liable for the supply of wheat done during the previous five days.

By Conduct of the Creditor -

133 - Variance in the terms of the contract

134 - Release or Discharge of the PD

135 - Creditor compromises with the PD (Extra time etc.)

Discharge of Surety by Conduct of the Creditor			
Section	Condition for Discharge of Surety	Explanation	Example
Section 133 Variance in Terms of Contract	Surety is discharged if the principal debtor and creditor vary the contract terms without the surety's consent.	The surety is no longer liable for transactions occurring after the variation.	A becomes surety for B's conduct as a manager in C's bank. Without A's consent, B's salary is increased, and B is made liable for overdraft losses. B allows an overdraft, resulting in a loss. A is discharged as surety.
Section 134 Release or Discharge of Principal Debtor	Surety is discharged if: 1. The creditor enters into a new contract with the principal debtor releasing the latter, or . 2. The creditor's action or omission leads to the legal discharge of the principal debtor.	Once the principal debtor is released or discharged, the surety is also released from liability.	Example 1: B fails to supply timber for a house, so C, who guaranteed A's performance, is discharged.
			Example 2: B assigns property to C in lieu of debt, discharging B and also A, the surety.
Section 135 Compounding, Giving Time, or Agreement Not to Sue	Surety is discharged if: 1. The creditor makes a composition (settlement) with the PD or 2. The creditor gives time or	Composition with the principal debtor without consulting the surety discharges the surety.	If a creditor gives more time to pay or promises not to sue, the surety is discharged unless they agree to it.
		The surety's right to demand payment is	

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Discharge of Surety by Conduct of the Creditor			
Section	Condition for Discharge of Surety	Explanation	Example
	3. Promises not to sue the debtor, unless the surety consents.	violated if the creditor gives the debtor more time or agrees not to sue.	

Some important point to keep in mind -

- Composition inevitably involves variation of the original contract, and, therefore, the surety is discharged.
- It is one of the duties of the creditor towards the surety not to allow the principal debtor more time for payment.
- Surety is entitled at any time to require the creditor to call upon the principal debtor to pay off the debt when it is due and this right is positively violated when the creditor promises not to sue the principal debtor.

CASES WHERE SURETY NOT DISCHARGED

136 - Surety not discharged when agreement is made with third person to give time to principal debtor

- 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 23: 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.

137 - Creditor's forbearance to sue does not discharge surety

- 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 24: 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.

139 - Discharge of surety by creditor's act or omission impairing surety's eventual remedy

- 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.

State bank of Saurashtra V Chitranjan Rangnath Raja (1980) 4 SCC 516

In a case before the Supreme Court of India,

- "A bank granted a loan on the security of the stock in the godown.
- The loan was also guaranteed by the surety.
- The goods were lost from the godown on account of the negligence of the bank officials.
- The surety was discharged to the extent of the value of the stock so lost."

Example 25: A puts M as apprentice to B and gives a guarantee to B for M's fidelity. B promises on his part that he will, at least once a month, see that M make up the cash. B omits to see this done as promised, and

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M embezzles. A is not liable to B on his guarantee.

By the invalidation of the contract of guarantee

142- Guarantee obtained by misrepresentation

143- Guarantee obtained by concealment

144- Guarantee on contract that creditor shall not act on it until co-surety joins

Discharge of Surety by the invalidation of the contract of guarantee			
Section	Condition for Invalidity of Guarantee	Explanation	Example
Section 142 Misrepresentation by Creditor	A guarantee obtained by misrepresentation from the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.	The guarantee is invalid if the creditor misrepresents material facts and the surety is unaware.	C sells an AC to P, falsely claiming it is made of copper, but it is made of aluminum. S guarantees the sale, unaware of the misrepresentation. S is not liable.
Section 143 Concealment of Material Facts	A guarantee obtained by keeping silence about material circumstances is invalid.	If the creditor fails to disclose important facts that would affect the surety's decision, the guarantee is invalid.	- Example 1: A does not inform C about B's past misconduct as a clerk, and C guarantees B. The guarantee is invalid.
			- Example 2: B agrees to pay more than the market price to C for iron to settle an old debt. This is concealed from

Discharge of Surety by the invalidation of the contract of guarantee			
Section	Condition for Invalidity of Guarantee	Explanation	Example
			A, the surety. A is not liable.
Section 144 Condition for Co-surety	If a person gives a guarantee on the condition that another person will also act as a co-surety, the guarantee is invalid if the other person does not join.	The guarantee is only valid if the other person joins as co-surety as agreed.	S1 guarantees payment by P to C, but only if S2 also joins as a co-surety. S2 does not join, so S1 is not liable.

RIGHTS OF A SURETY

The surety enjoys the following rights against the creditor:

- (a) Rights against the creditor (141, Set off and Reduction)
- (b) Rights against the principal debtor (140 and 145)
- (c) Rights against co-sureties (146 and 147)

Right against the principal debtor

140- Rights of subrogation

- 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 the 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.

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Example 30: 'Raju' has taken a housing loan from Canara Bank. 'Pappu' has given guarantee for repayment of such loan. Besides, there was a condition that if 'Raju' does not repay the loan within time, the bank can auction his property by giving 15 days notice to 'Raju'. On due date 'Raju' does not repay, hence Pappu being a surety has to repay the loan. Now 'Pappu' can take the house from the bank and has a right to auction the house by giving 15 days notice to 'Raju'.

145 - Implied promise to indemnify surety

- 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**.

Example 31: B is indebted to C and A is surety for the debt. Upon default, C sues A. A defends the suit on reasonable grounds but is compelled to pay the amount. A is entitled to recover from B the cost as well as the principal debt. In the same case above, if A did not have reasonable grounds for defence, A would still be entitled to recover principal debt from B but not any other costs.

Right against the Creditor

141 - 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.

Example 32: 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.

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

Example 33: 'X' took a loan of Rs. 50,000 from 'Y' which was guaranteed by 'Z'. There was one another contract between 'X' and 'Y' in which 'Y' had to pay Rs. 10,000 to 'X'. On default by 'X', 'Y' filed suit against 'Z'. Now 'Z' is liable to pay Rs. 40,000 (Rs. 50,000 – Rs. 10,000).

Right to share reduction:

- The surety has the right to claim
- proportionate reduction in his liability
- if the principal debtor becomes insolvent.

Example 34: 'X' took a loan of ` 50,000 from 'Y' which was Guaranteed by 'Z'. 'X' became insolvent & only 25% is realised from his property against liabilities. Now 'Y' will receive ` 12,500 from 'X' and Now 'Z' is liable to pay 37,500 (50,000 – 12,500).

Rights Against Co-Sureties

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Co-sureties means -

When the same debt or duty is guaranteed by two or more persons, such persons are called co-sureties"

146 - Co-sureties liable to contribute equally :

- Unless otherwise agreed,
- each surety is liable to contribute equally
- for discharge of whole debt or part of the debt
- remains unpaid by debtor.

Example 35: 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 36: 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.

147 - Liability of co-sureties bound in different sums -

- The principal 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 37: 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.

Example 38: 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 39: 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.

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“ PROBLEM KYA HAI ? - Unit 7 ”

Question Bank ICA

*This section is complied with questions and suggested answers
for the chapter - ICA*

- ❖ *ICAI Study material*
- ❖ *Previous year Question Papers (PYQPs)*
- ❖ *Mock Test Papers (MTPs)*
- ❖ *Revision Test Papers (RTPs)*

Compiled by - CA Chaitanya Jain

Question 1

What are the rights of the indemnity-holder when sued?

(Module)

Answer 1

Rights of Indemnity- holder when sued (Section 125): The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor

- a. all damages which he may be compelled to pay in any suit
- b. all costs which he may have been compelled to pay in bringing/ defending the suit and
- c. all sums which he may have paid under the terms of any compromise of suit.

It may be understood that the rights contemplated under section 125 are not exhaustive. The indemnity holder/ indemnified has other rights besides those mentioned above. 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.

Question 2

Define contract of indemnity and contract of guarantee and state the conditions when guarantee is considered invalid?

(Module)

Answer 2

Section 124 of the Indian Contract Act, 1872 states that "A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or the conduct of any person", is called a "contract of indemnity": Section 126 of the Indian Contract Act, 1872 states that "A contract to perform the promise made or discharge liability incurred by a third person in case of his default" is called a "contract of guarantee".

The conditions under which the guarantee is invalid or void is provided in section 142, 143 and 144 of the Indian Contract Act. These include:

1. Guarantee obtained by means of misrepresentation.
2. Guarantee obtained by means of keeping silence as to material circumstances.

Question Bank —> Chap 2 (Unit 7) - ICA, 1872

3. When contract of guarantee is entered into on the condition that the creditor shall not act upon it until another person has joined in it as co-surety and that other party fails to join as such.

Question 3

Mr. X, is employed as a cashier on a monthly salary of Rs. 12,000 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 Rs. 10,500/- 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?

(Module)

Answer 3

According to section 133 of the Indian Contract Act, 1872, 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.

In the instant case, the creditor has made variance (i.e. change in terms) without the consent of surety.

Thus, surety is discharged as to the transactions subsequent to the change.

Hence, 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.

Question 4

A contracts with B for a fixed price to construct a house for B within a stipulated time. would supply the necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C discharged from his liability.

Answer 4

According to Section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor by which the principal debtor is discharged or by any act or omission for the creditor the legal consequence of which is the discharge of the principal debtor.

Question Bank —> Chap 2 (Unit 7) - ICA, 1872

In the given case, B omits to supply the necessary construction material. Hence, C is discharged from his liability.

Question 5

Mr. D was in urgent need of money amounting to \$ 5,00,000. He asked Mr. K for the money. Mr. K lent the money on the sureties of A, B and N without any contract between them in case of default in repayment of money by D to K. D makes default in payment. B refused to contribute, examine whether B can escape liability?

(Module)

Answer 5

Co-sureties liable to contribute equally (Section 146 of the Indian Contract act, 1872): 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".

Accordingly, on the default of D in payment, B cannot escape from his liability. All the three sureties A, B and are liable to pay equally, in absence of any contract between them.

Question 6

Mr. Chetan was appointed as Site Manager of ABC Constructions Company on a two years' contract at a monthly salary of Rs. 50,000. Mr. Pawan gave a surety in respect of Mr. Chetan's conduct. After six months the company was not in position to pay Rs. 50,000 to Mr. Chetan because of financial constraints.

Chetan agreed for a lower salary of Rs. 30,000 from the company. This was not communicated to Mr. Pawan. Three months afterwards it was discovered that Chetan had been doing fraud since the time of his appointment. What is the liability of Mr. Pawan during the whole duration of Chetan's appointment.

Answer 6

Question Bank —> Chap 2 (Unit 7) - ICA, 1872

As per the provisions of Section 133 of the Indian Contract Act, 1872, 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, Mr. Pawan is liable as a surety for the loss suffered by ABC Constructions company due to misappropriation of cash by Mr. Chetan during the first six months but not for misappropriations committed after the reduction in salary.

Hence, Mr. Pawan, will be liable as a surety for the act of Mr. Chetan before the change in the terms of the contract i.e., during the first six months. Variation in the terms of the contract (as to the reduction of salary) without consent of Mr. Pawan, will discharge Mr. Pawan from all the liabilities towards the act of the Mr. Chetan after such variation.

Question 7

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.

(Module)

Answer 7

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.

Question 8

S asks R to beat T and promises to indemnify R against the consequences. R beats T and is fined 50,000. Can R claim Rs. 50,000 from S.

(Module)

Question Bank —> Chap 2 (Unit 7) - ICA, 1872

Answer 8

R cannot claim Rs. 50,000 from S because the object of the agreement was unlawful. A contract of indemnity to be valid must fulfil all the essentials of a valid contract.

Question 9

Manoj guarantees for Ranjan, a retail textile merchant, for an amount of Rs. 1,00,000, for which Sharma, the supplier may from time to time supply goods on credit basis to Ranjan during the next 3 months.

After 1 month, Manoj revokes the guarantee, when Sharma had supplied goods on credit for Rs. 40,000. Referring to the provisions of the Indian Contract Act, 1872, decide whether Manoj is discharged from all the liabilities to Sharma for any subsequent credit supply. What would be your answer in case Ranjan makes default in paying back Sharma for the goods already supplied on credit i.e. Rs. 40,000?

(Module)

Answer 9

Discharge of Surety by Revocation: As per section 130 of the Indian Contract Act, 1872, a continuing guarantee may, at any time, be revoked by the surety, as to future transactions, by notice to the creditor, but the surety remains liable for transactions already entered into.

As per the above provisions, liability of Manoj is discharged with relation to all subsequent credit supplies made by Sharma after revocation of guarantee, because it is a case of continuing guarantee.

However, liability of Manoj for previous transactions (before revocation) i.e. for Rs. 40,000 remains.

He is liable for payment of Rs. 40,000 to Sharma because the transaction was already entered into before revocation of guarantee.

Question 10

"C" advances to 'B', Rs. 2,00,000 on the guarantee of 'A'. 'C' has also taken a further security for the same borrowing by mortgage of B's furniture worth Rs. 2,00,000 without knowledge of 'A'. 'C' cancels the mortgage. After 6 months 'B' becomes insolvent and 'C' 'sues 'A' his guarantee. Decide the liability of 'A' if the market value of furniture is worth Rs. 80,000, under the Indian Contract Act, 1872.

(Module)

Question Bank —> Chap 2 (Unit 7) - ICA, 1872

Answer 10

Surety's right to benefit of creditor's securities: According to section 141 of the Indian Contract Act, 1872, 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.

In the instant case, C advances to B, Rs. 2,00,000 rupees on the guarantee of A. C has also taken a further security for Rs. 2,00,000 by mortgage of B's furniture without knowledge of A. 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 i.e. \$80,000 and will remain liable for balance Rs. 1,20,000.

RTP, MTP & PYP Questions

Question 1

Sarthak is employed as a cashier on a monthly salary of \$ 50,000 by ABC bank for a period of three years. Mohit gave surety for Sarthak's good conduct. After nine months, the financial position of the bank deteriorates. Then Sarthak agrees to accept a lower salary of \$ 40,000 per month from the Bank. Two months later, it was found that Sarthak had misappropriated cash from the time of his appointment. What is the liability of Mohit taking into account the provisions of the Indian Contract Act, 1872?

(RTP Jun'24)

Answer 1

According to section 133 of the Indian Contract Act, 1872, 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.

In the instant case, the creditor has made a variance (i.e. change in terms) without the consent of surety. Thus, surety is discharged as to the transactions subsequent to the change.

Question Bank —> Chap 2 (Unit 7) - ICA, 1872

Hence, Mohit is liable as surety for the loss suffered by the bank due to misappropriation of cash by Sarthak during the first nine months but not for misappropriations committed after the reduction in salary.

Question 2

Define contract of indemnity and contract of guarantee and state the conditions when guarantee is considered invalid ?

(Nov'21, Apr' 19, Oct'19, 4 Marks) (SM)

Answer 2

Section 124 of the Indian Contract Act, 1872 says that "A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or the conduct of any person", is called a "contract of indemnity". Section 126 of the Indian Contract Act says that "A contract to perform the promise made or discharge liability incurred by a third person in case of his default." is called as "contract of guarantee".

The conditions under which the guarantee is invalid or void are stated in section 142, 143 and 144 of the Indian Contract Act are :

1. Guarantee obtained by means of misrepresentation.
2. creditor obtained any guarantee by means of keeping silence as to material circumstances.
3. When contract of guarantee is entered into on the condition that the creditor shall not act upon it until another person has joined in it as co-surety and that other party fails to join as such.

Question 3

Enumerate the following as per the provisions of the Indian Contract Act, 1872:

1. Meaning of contract of guarantee
2. Parties to a contract of guarantee.

(MTP 4 Marks March 22)

Answer 3

1. **Contract of guarantee:** As per the provisions of section 126 of the Indian Contract Act, 1872, 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.
2. Three parties are involved in a contract of guarantee:
Surety- person who gives the guarantee,

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Principal debtor- person in respect of whose default the guarantee is given,

Creditor- person to whom the guarantee is given

Question 4

Distinguish between a contract of Indemnity and a contract of Guarantee as per the Indian Contract Act, 1872. (4 Marks) (Oct 22)

Answer 4

Point of distinction	Contract of Indemnity	Contract of Guarantee
Number of party/ Parties to the contract	there are only two parties namely the indemnifier [promisor] and the indemnified {promisee}	there are three parties creditor, principal debtor and surety.
Nature of liability	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.
Time of liability	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.
Time to Act	The indemnifier need not act at the request of indemnity holder	The surety acts at the request of principal debtor.
Right to sue third party	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.
Purpose	Reimbursement of loss	For the security of the creditor
Competency to contract	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.

Question 5

Satya has given his residential property on rent amounting to * 25,000 per month to Tushar. Amit became the surety for payment of rent by Tushar. Subsequently, without Amit's consent, Tushar agreed to pay higher rent to Satya. After a few months of this, Tushar defaulted in paying the rent. Explain the meaning of contract of guarantee according to the provisions of the Indian Contract Act, 1872. State the position of Amit in this regard.

(4 Marks Jan 21)

Answer 5

1. **Contract of guarantee:** As per the provisions of section 126 of the Indian Contract Act, 1872, 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.

Three parties are involved in a contract of guarantee:

Surety- person who gives the guarantee,

Principal debtor- person in respect of whose default the guarantee is given,

Creditor- person to whom the guarantee is given

2. According to the provisions of section 133 of the Indian Contract Act, 1872, 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.

In the instant case, Satya (Creditor) cannot sue Amit (Surety), because Amit is discharged from liability when, without his consent, Tushar (Principal debtor) has changed the terms of his contract with Satya (creditor). It is immaterial whether the variation is beneficial to the surety or does not materially affect the position of the surety.

Question 6

Manish, a minor, lost his parents in COVID-19 pandemic. Due to poor financial background Manish was facing difficulties in maintaining his livelihood. He approached Mr. Soheli (a grocery shopkeeper) to supply him grocery items and to wait for some period for receiving his dues. Mr. Soheli did not agree with the proposal; but when Mr. Ganesh, a local person, who is a major, agreed to provide guarantee that he would pay the dues in case Manish fails to pay the amount, Mr. Soheli supplied the required groceries to Manish. After few months when Manish failed to clear his dues, Mr. Soheli approached Mr. Ganesh and asked him to clear

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the dues of Manish. Mr. Ganesh refused to pay the amount on two grounds; firstly, that there was no consideration in the contract of guarantee and secondly that Manish is a minor and therefore on both the grounds the contract of guarantee is not valid.

Referring to the relevant provisions of the Indian Contract Act, 1872, decide, whether the contention of Mr. Ganesh, (the surety) is tenable? Will your answer differ in case both Manish (the principal debtor) and Mr. Ganesh (the surety) are minors?

(PYP 4 Marks Nov'22)

Answer 6

1. Whether the contention of Mr. Ganesh (the Surety) is Tenable?

In the light of the given facts in the question, the guarantee was given by Mr. Ganesh (the surety) to Mr. Sohel that he would pay the dues in case Mr. Manish (the Principal Debtor) fails to pay the amount.

However, later on it was contended by Mr. Ganesh that there was no consideration in the contract of guarantee and also that Manish is a minor and therefore the contract of guarantee is not valid.

As per the provisions of Section 127 of the Indian Contract Act, 1872, anything done, or promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.

In the given case, Mr. Ganesh has provided guarantee to Mr. Sohel for the benefit of Mr. Manish which will be treated as sufficient consideration even though there is absence of direct consideration. In other words, a guarantee without consideration is void, but there is no need for a direct consideration between the surety and the creditor.

Regarding the contention that Manish is a minor and therefore, the contract of guarantee will be invalid is not tenable due to the fact that Mr. Ganesh (surety) and Mr. Sohel (the creditor) are not minors. In other words, the capability of the principal debtor (being a minor) does not affect the validity of the agreement of the guarantee.

In view of the above, it can be concluded that the contention of Mr. Ganesh is not tenable.

2. In case both Manish (the principal debtor) and Mr. Ganesh (the surety) are minors:
The answer will differ in case both Manish (the principal debtor) and Mr. Ganesh (the surety) are minors. In such a situation, the agreement will be treated as void

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from inception as the minors cannot give guarantee even with a claim for necessities.

Question 7

Paul (minor) purchased a smart phone on credit from a mobile dealer on the surety given by Mr. Jack, (a major). Paul did not pay for the mobile. The mobile dealer demanded the payment from Mr. Jack because the contract entered with Paul (minor) is void. Mr. Jack argued that he is not liable to pay the amount since Paul (Principal Debtor) is not liable. Whether the argument is correct under the

Indian Contract Act, 1872? What will be your answer if Jack and Paul both are minor?

(PYP July 21,4 Marks)

Answer 7

In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid. In the given question, the contract is a valid contract and Jack (major) shall be liable to pay the amount even if Paul (Principal debtor) is not liable (as Paul is minor). If both Jack and Paul are minors then the agreement of guarantee is void because the surety as well as the principal debtor are incompetent to contract.

Question 8

Y advances Z a loan of Rs. 10,000 on the guarantee of X, at an interest of 10%. Subsequently, as Z was having some financial problems, Y reduced the rate of interest to 7% and also extended time for repayment of loan without the consent of X. Z becomes insolvent. Can Y sue X for recovery of amount?

(4 Marks Oct 21) (SM)

Answer 8

According to section 133 of the Indian Contract Act, 1872, 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.

Accordingly, Y cannot sue X, because a surety (X) is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor (2), no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety.

Question 9

Ricky is the owner of electronics shop. Prisha reached the shop to purchase an air conditioner whose compressor should be of copper. As Prisha wanted to purchase the air conditioner on credit, Ricky demand a guarantor for such transaction. Mr. Shiv (a friend of Prisha) came forward and gave the guarantee for payment of air conditioner. Ricky sold the air conditioner of a particular brand, misrepresenting that it is made of copper while it is made of aluminium. Neither Prisha nor Mr. Shiv had the knowledge of fact that it is made of aluminium. On being aware of the facts, Prisha denied for payment of price. Ricky filed the suit against Mr. Shiv. Explain with reference to the Indian Contract Act 1872, whether Mr. Shiv is liable to pay the price of air conditioner?

(Oct'22)(RTP Nov 21)

Answer 9

As per the provisions of section 142 of the Indian Contract Act 1872, where the guarantee has been obtained by means of misrepresentation made by the creditor concerning a material part of the transaction, the surety will be discharged. Further according to provisions of section 134, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

In the given question, Prisha wanted to purchase air conditioner whose compressor should be of copper, on credit from Ricky. Mr. Shiv has given the guarantee for payment of price. Ricky sold the air conditioner of a particular brand on misrepresenting that it is made of copper while it is made of aluminium of which both Prisha & Mr. Shiv were unaware. After being aware of the facts, Prisha denied for payment of price. Ricky filed the suit against Mr. Shiv for payment of price.

On the basis of above provisions and facts of the case, as guarantee was obtained by Ricky by misrepresentation of the facts, Mr. Shiv will not be liable. He will be discharged from liability.

Question 10

Examine the validity of the following statements under the provisions of the Indian Contract Act, 1872.

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1. Creditor should proceed legal action first against the Principal Debtor and later against the surety.
2. A guarantee which extends to a single debt/ specific transaction is called continuing Guarantee.

(4 Marks April 23)

Answer 10

1. Creditor should proceed legal action first against the Principal Debtor and later against the surety: Invalid
Reasoning: As per Section 128 of the Indian Contract Act, 1872, the surety's liability is co- extensive with that of Principal debtor. It's not mandatory that creditor should proceed legal action in case of default, first against the Principal debtor and later against the surety. It is on creditor to start action first either against the Principal debtor or the surety.
2. A guarantee which extends to a single debt/ specific transaction is called continuing Guarantee: Invalid Reasoning: Continuing Guarantee [Section 129 of the Indian Contract Act, 1872) - A guarantee which extends to a series of transaction is called a continuing guarantee. 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.

Question 11

Explain the following as per the provisions of the Indian Contract Act, 1872

1. Specific Guarantee
2. General Guarantee.

(4 Marks Apr'23)

Answer 11

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.

Continuing Guarantee- 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.

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.

Question 12

'Surendra' guarantees 'Virendra' for the transactions to be done between 'Virendra' & 'Jitendra' during the month of March, 2021. 'Virendra' supplied goods of \$ 30,000 on 01.03.2021 and of \$ 20,000 on 03.03.2021 to 'Jitendra'. On 05.03.2021, 'Surendra' died in a road accident. On 10.03.2021, being ignorant of the death of 'Surendra', 'Virendra' further supplied goods of Rs. 40,000. On default in payment by 'Jitendra' on due date, 'Virendra' sued on legal heirs of 'Surendra' for recovery of Rs. 90,000. Describe, whether legal heirs of 'Surendra' are liable to pay Rs. 90,000 under the provisions of Indian Contract Act 1872. What would be your answer, if the estate of 'Surendra' is worth of Rs. 45,000 only?

(May 22)

Answer 12

According to section 131 of Indian Contract Act 1872, in the absence of a contract to contrary, a continuing guarantee is revoked by the death of the surety as to the future transactions. The estate of deceased surety, however, liable for those transactions which had already taken place during the lifetime of deceased. Surety's estate will not be liable for the transactions taken place after the death of surety even if the creditor had no knowledge of surety's death.

In this question, 'Surendra' was surety for the transactions to be done between 'Virendra' & 'Jitendra' during the month of March 2021. 'Virendra' supplied goods of Rs. 30,000, Rs. 20,000 and of Rs. 40,000 on 01.03.2021, 03.03.2021 and 10.03.02021 respectively. 'Surendra' died in a road accident but this was not in the knowledge of 'Virendra'. When 'Jitendra' defaulted in payment, 'Virendra' filed suit against legal heirs of 'Surendra' for recovery of full amount i.e. Rs. 90,000. On the basis of above, it can be said in case of death of surety ('Surendra'), his legal heirs are liable only for those transactions which were entered before 05.03.2021 i.e. for Rs. 50,000. They are not liable for the transaction done on 10.03.2021 even though Virendra had no knowledge of death of Surendra.

Further, if the worth of the estate of deceased is only Rs. 45,000, the legal heirs are liable for this amount only.

Question 13

Mr. Salil purchased furniture of worth Rs. 1,00,000 from Mr. Pooran on credit. Mr. Raman entered in contract with Mr. Pooran for the guarantee of the payment by Mr. Salil. On due date, Mr. Salil could not make the payment due to his financial crisis. Mr. Pooran filed the suit against Mr. Raman for payment. Meanwhile father

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of Mr. Salil paid Rs. 20,000 to Mr. Pooran on behalf of his son. Mr. Raman, in ignorance of above payment, paid Rs. 1,00,000 to Mr. Pooran as surety. Afterwards, when Mr. Raman knew the facts, he asked Mr. Pooran for refund of Rs. 20,000. Mr. Pooran denied for refund with the words, that's only Mr. Salil who can claim the amount of Rs. 20,000. Explain, with reference to Indian Contract Act 1872, whether Mr. Raman (surety) can claim the refund of Rs. 20,000 from Mr. Pooran?

(May 23)

Answer 13

As per the provisions of section 128 of the Indian Contract Act, 1872, the liability of the surety is coextensive with that of the principal debtor, unless it is otherwise provided by the contract. In other words, the surety is liable for all those amounts, the principal debtor is liable for.

In the given question, before Mr. Raman makes the payment (on default of Mr. Salil), the father of Mr. Salil paid Rs. 20,000 to Mr. Pooran on behalf of his son. Unaware of the payment of Rs. 20,000, Mr. Raman paid the full amount to Mr. Pooran.

The liability of Mr. Raman (surety) is co-extensive with that of Mr. Salil (principal debtor). As the father of Mr. Salil made payment of Rs. 20,000 on Salil's behalf, Mr. Raman is liable only for Rs. 80,000 to Mr. Pooran (creditor). Mr. Raman made the full payment without the knowledge of facts. Therefore, he can claim the refund of Rs. 20,000 from Mr. Pooran.

Question 14

Mr. Sanjeev is dealing in high quality timber. Mr. Amit wants to purchase the timber from him on credit which is to be used in renovation of his house. Mr. Pramod gives a guarantee to Mr. Sanjeev for timber to be supplied by Mr. Sanjeev to Mr. Amit. Mr. Sanjeev supplied the required timber to Mr. Amit.

Afterwards, Mr. Amit embarrassed and contracts with his creditors (including Mr. Sanjeev) to assign to them his property in consideration of their releasing him from their demands. On due date, Mr. Sanjeev filed the suit against Mr. Pramod for recovery of the payment of timber due to Mr. Amit. Explain, with reference to Indian Contract Act 1872, whether Mr. Sanjeev can claim the payment from Mr. Pramod?

(Nov' 23)

Answer 14

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Section 134 of the Indian Contract Act 1872 provides that the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor. In other words, if principal debtor is discharged surety will also be discharged.

On the basis of provisions and facts of the case, it is clear that on assigning his property to creditors, Mr. Amit is released from his liability against his creditors including Mr. Sanjeev. Now, by following the provisions of section 134, as Mr. Amit (principal debtor) is released, Mr. Pramod (surety) will be discharged. Hence, Mr. Sanjeev cannot claim the payment from Mr. Pramod.

Question 15

Due to urgent need of money amounting to Rs. 3,00,000, Pawan approached Raman and asked him for the money. Raman lent the money on the guarantee of Suraj, Tarun and Usha. Pawan makes default in payment and Suraj pays full amount to Raman. Suraj, afterwards, claimed contribution from Tarun and Usha refused to contribute on the basis that there is no contract between Suraj and him. Examine referring to the provisions of the Indian Contract Act, 1872, whether Tarun can escape from his liability.

(4 Marks Dec 21)

Answer 15

Equality of burden is the basis of Co-suretyship. This is contained in section 146 of the Indian Contract Act, 1872, 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".

Accordingly, on the default of Pawan in payment, Tarun cannot escape from his liability. All the three sureties Suraj, Tarun and Usha are liable to pay equally, in absence of any contract between them.

Question 16

Alpha Motor Ltd. agreed to sell a bike to Ashok under hire-purchase agreement on guarantee of Abhishek. The Terms were: hire-purchase price Rs. 96,000 payable in 24 monthly instalments of Rs. 8,000 each. Ownership to be transferred on the

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payment of last instalment. State whether Abhishek is discharged in each of the following alternative case under the provisions of the Indian Contract Act, 1872:

1. Ashok paid 12 instalments but failed to pay next two instalments. Alpha Motor Ltd. sued Abhishek for the payment of arrears and Abhishek paid these two instalments i.e. 13th and 14th. Abhishek then gave a notice to Alpha Motor Ltd. to revoke his guarantee for the remaining months.
2. If after 15th months, Abhishek died due to COVID-19.

(4 Marks Dec 21)

Answer 16

According to section 130 of the Indian Contract Act, 1872, the continuing guarantee may at any time be . revoked by the surety as to future transactions by notice to the creditors. Once the guarantee is revoked, the surety is not liable for any future transaction however he is liable for all the transactions that happened before the notice was given.

A specific guarantee can be revoked only if liability to principal debtor has not accrued.

1. In the given question Ashok paid 12 instalments (out of total 24 monthly instalments), but failed to pay next two instalments. Abhishek (guarantor) paid the 13th and 14th installments but then he revoked guarantee for the remaining months. Thus, Abhishek is not liable for installments that was made after the notice, but he is liable for installments made before the notice (which he had paid i.e. 13th and 14th installments).
2. According to section 131 of the Indian Contract Act, 1872, 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.

In the given question, Abhishek (guarantor) died after 15th month. This will operate as a revocation of a continuing guarantee as to the future transactions taking place after the death of surety (i.e. Abhishek).

However, the Abhishek's estate remains liable for the past transactions (i.e. 15th month and before) which have already taken place before the death of the surety.

Question 17

'S' guarantees 'V' for the transactions to be done between 'V' & 'B' during the month of March, 2022. "V" supplied goods of Rs. 30,000 on 01.03.2022 and of Rs.

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20,000 on 03.03.2022 to 'B'. On 05.03.2022, 'S' died in a road accident. On 10.03.2022, being ignorant of the death of 'S', 'V' further supplied goods of 40,000. On default in payment by 'B' on due date, 'V' sued on legal heirs of 'S' for recovery of 90,000. Describe, whether legal heirs of 'S' are liable to pay Rs. 90,000 under the provisions of Indian Contract Act, 1872.

What would be your answer, if the estate of 'S' is worth of Rs. 45,000 only?

(4 Marks, May 23)

Answer 17

Revocation of continuing guarantee by surety's death (Section 131 of the Indian Contract Act, 1872): 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.

Accordingly, in the given instance, legal heirs of S are not liable to pay Rs. 90,000 but for Rs. 50,000 as death of surety operates as a revocation of a continuing guarantee as to the future transactions, i.e., Rs. 40,000 in this case, taking place after the death of surety.

Further, surety's estate remains liable for the transactions taken place before the death of the surety.

Legal heirs of surety will be obliged to perform the contract on behalf of surety to the extent of share inherited. V shall be entitled to recover Rs. 45,000 only from the estate of S.

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