

Surety's Liability

Extent of Surety's Liability

The liability of surety is co-extensive with that of the principal debtor. It means that the liability of a surety is the same as that of a principal debtor unless there is a contract to the contrary. The surety's liability can be made limited than that of the principal debtor. [Sec. 128]

EXAMPLE

A guarantees to B for payment of a bill accepted by C. The bill is dishonored. A is liable for the payment.

Nature of Surety's Liability

The following are rules regarding the nature of surety's liability:

1. The liability of surety is secondary. It arises on the default of principal debtor.
2. The liability of surety arises immediately on the default of principal debtor; unless there is a provision in the contract that creditor must file a suit against principal debtor or give notice of default to surety.
3. Where a creditor holds securities from principal debtor for his debt, the creditor should first sue the surety before resorting to securities unless agreed otherwise.
4. The surety is not liable where the creditor has obtained guarantee by misrepresentation.
5. The law does not treat the principal debtor and surety as one person. It is not necessary that surety will be liable only if principal debtor is liable.

- 6. The discharge of principal debtor by operation of law does not discharge the surety, e.g. material alteration.
- 7. Liability of surety does not come to an end on the death of principal debtor.

Kinds of Guarantee

The following are different kinds of guarantee:

- 1. Specific Guarantee / ordinary ⇒ can not revoke)

A guarantee which extends to a single debt or transaction is called ordinary, simple or specific guarantee. The liability of surety comes to an end when the guaranteed debt is discharged or transaction is performed.

EXAMPLE

G guarantees K for payment of 5 bags of wheat purchased by C. C makes the payment. Later, C again purchases 5 bags of wheat but did not pay. K sued G. Held, G's guarantee is specific guarantee and G is not liable. (Kyk vs. Groves)

- 2. Continuing Guarantee (Revoke Future transactions)

A guarantee which is given for a series of transactions is called continuing guarantee. It is a guarantee which is given for a series of transactions of continuous nature. It is like a standing offer which is accepted by the creditor every time a subsequent transaction takes place. A surety's liability continues until the revocation of guarantee. [Sec. 129]

EXAMPLES

D guarantees C for B's purchases from C to the extent of Rs. 5,000 for the next one year. This is a continuing guarantee.

Rights of Surety

A surety has the following rights:

- 1. Rights against Creditor

The surety has the following rights against the creditor:

- a. Right to Claim Securities

After the payment of debt or discharge of obligation, the surety can demand the securities which creditor has received from principal debtor at the time of creation of contract, whether surety is aware of such securities or not. If creditor by negligence loses any security, the liability of the surety reduces proportionately. But if security is lost due to unavoidable act, the surety shall remain liable. [Sec. 141]

EXAMPLE

C gives a loan of Rs. 2 Lac to B on the guarantee of X. C also pledges B's car. B fails to pay the loan and X pays Rs. 2 Lac to C. X can get the car from C.

b. Right to Claim Set-off

The term set-off means a counter claim or deduction from the amount of loan. Sometimes, the principal debtor is entitled to certain counter claims or deductions from the amount loan taken from the creditor. In such cases, if the creditor files a suit, the debtor can ask for adjustment of his debts to the extent of his claims. If creditor sues surety for repayment, the surety can claim set off, if any, which principal debtors had against creditor.

EXAMPLE

A supplies furniture worth Rs. 2 Lac to B on the guarantee of C. B claims that some furniture is defective and refuses to pay Rs. 20,000. C can ask for adjustment of Rs. 20,000.

2. Rights against Principal Debtor

The surety has following rights against principal debtor:

a. Right of Subrogation

According to the principle, when surety has paid the guaranteed debt or performed the contract on default of principal debtor, he is entitled to all the rights which creditor had against the principal debtor. The surety is entitled to all the remedies which are available to creditor against principal debtor. [Sec. 140]

EXAMPLE

X borrowed money from Y on the guarantee of W and mortgaged his house to Y. X failed to pay and W paid. Now, W can enforce the mortgage of the house against X.

b. Right of Indemnity

In every contract of guarantee, there is an implied promise by principal debtor to indemnify the surety. The surety is entitled to recover from principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully. [Sec. 145]

EXAMPLE

B owes Rs. 1 Lac to C, and A is the surety. B fails to pay. C demands payment from A. A refuses to pay. C sues A for the money. A defends the suit on reasonable grounds but loses and pays debts with cost of suits. A can recover the whole amount from B.

3. Rights against Co-sureties

Where a debt or obligation is guaranteed by more than one surety, they are called co-sureties. In such a case, all the sureties are liable to make the payment to creditor according to the agreement among them. If there is no agreement and one of the co-sureties is compelled to pay the entire debt, he has a right to contribution from the co-sureties. Following are the rules in this regard: [Sec. 146-147]

a. Similar Amount

When there are sureties for the same debt and the principal debtor committed a default, each party is liable to contribute equally to the extent of default.

EXAMPLE

A, B and C are sureties to D for sum of Rs. 3000 lent to E. E makes default in payment. A, B and C are liable to pay Rs. 1000 each. If C becomes insolvent and only pays Rs. 500, then A and B will contribute equally.

b. Different Amount

When there are sureties for the same debt for different sums, they are bound to contribute equally subject to the limit fixed by their guarantee. They do not contribute proportionately.

EXAMPLES

A, B and C are sureties for D. A, B and C guarantee for Rs. 10,000, 20,000 and 40,000 respectively.

- If D makes default in payment to the extent of Rs. 30,000 then liability of A, B and C is Rs. 10,000 each.
- If D makes default to the extent of Rs. 40,000 then liability of A is Rs. 10,000, B is Rs. 15,000 and C is Rs. 15,000.
- If D makes default to the extent of Rs. 70,000 then A, B and C will pay Rs. 10,000, Rs. 20,000 and Rs. 40,000 respectively.

Discharge of Surety from Liability

A surety is discharged from his liability in the following ways:

1. Notice of Revocation

A specific guarantee can be revoked by notice if the liability has not occurred. But a continuing guarantee may be revoked anytime by the surety as to future transactions by giving a notice to the creditor. The surety remains liable for transactions entered into prior to the notice. [Sec. 130]

EXAMPLE

A lends B a certain sum on the guarantee of C. C cannot revoke the guarantee. But if A has not yet given the sum to B, then C may revoke the guarantee by giving a notice.

2. Death of Surety

In specific guarantee, the surety is not discharged from liability on his death if liability has already occurred. But in continuing guarantee, the death of surety discharges him from liability regarding the transactions which take place after his death, unless there is a contract to the contrary. The estate of deceased surety will remain liable for past transactions. [Sec. 131]

EXAMPLE

A sells goods to B for Rs. 1 Lac. C guarantees payment. A delivers goods worth Rs. 50,000. Later, C dies. C's property is liable up to Rs. 50,000.

3. Change in Terms of Contract

When any change is made in the terms of the contract by principal debtor and creditor without the surety's consent, the surety stands discharged with respect to transactions subsequent to the change. [Sec. 133]

EXAMPLE

M contracts to lend Rs.1 Lac to N on 1st March. S guarantees payment. M pays the amount on 1 Jan. S is discharged from his liability.

4. Release or Discharge of Principal Debtor

The surety is discharged by any contract between the creditor and principal debtor by which 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. [Sec. 134]

EXAMPLES

- A contracts to build a house for B. C guarantees for the performance. If B releases A from performance of the contract, the surety is discharged.
- A contracts to build house for B. B is liable to supply wood. C guarantees A's performance of the contract. B fails to supply the wood. C is discharged from his liability.

5. Arrangement without Surety's Consent

When the creditor makes a composition or promises to give time or not to sue principal debtor, without the consent of surety, the surety will be discharged. [Sec.135]

Where a contract to give time to principal debtor is made by the creditor with a third person and not with principal debtor, the surety is not discharged. [Sec. 136]

EXAMPLES

- P purchased a car from C on guarantee of S. C gave P more time for payment. Held, the giving of time to P for payment discharged S from his liability. (M.M. Showroom Ltd vs. Newman)
- A lends Rs. 10 Lac to B for 1 year on the guarantee of C. A promises X, a friend of B, to give more time to B to return the loan. C is not discharged from his liability.

6. Creditor's Act or Omission

If the creditor does any act which is inconsistent with rights of the surety, or omits to do any act which his duty to the surety requires him to do, and the

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eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged. [Sec. 139]

EXAMPLES

- a. B contracts to build a ship for C for Rs. 90 Lac to be paid by installments as the work reaches certain stages. A guarantees C for B's performance. Without telling A, C prepays last two installments to B. A is discharged by this prepayment.
- b. A employs B as a cashier on the guarantee of M. A promises to count the cash at least once a month. A does not count the cash. B commits fraud. M is not liable to A.

7. Loss of Security

If the creditor loses or without the consent of the surety, parts with the security given by the principal debtor against the debt, the surety is discharged from liability to the extent of the value of security. If the security is lost due to an act of God, the surety will not be discharged. [Sec. 141]

EXAMPLE

A advances Rs. 2 Lac to B on the guarantee of X. A gets an additional security of Rs. 50,000 by pledge of B's car. A cancels the pledge and returns the car. B becomes insolvent. X is discharged from liability to the extent of value of car.

8. Invalidation of Contract

The surety is liable if contract of guarantee is valid. A surety is discharged from liability when the contract of guarantee is invalid. It is invalid in the following cases: [Sec. 142-144]

- a. Where guarantee is obtained by misrepresentation.
- b. Where guarantee is obtained by concealment of material facts.
- c. Where guarantee is obtained under the impression that co-sureties will join and if, no body joins.
- d. Where it lacks some essentials of a valid contract, e.g. surety is incompetent to contract or object is illegal.

EXAMPLES

- a. A employs B as clerk. B commits fraud. Later, A asks C for guarantee without informing C about B's previous conduct. C gives guarantee for B's conduct. B again commits fraud. The guarantee is invalid.
- b. B signed a guarantee under the impression that three other persons would also sign it. One of them died without signing. The guarantee is not enforceable. (NP Bank of England vs. Brackenbury)