
MULTIDIMENSIONAL PERSONALITY OF THE ‘SURETY’

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INTRODUCTION

The Indian Contract Act is divided into two sections: the General Provision, which covers sections 1 through 75 of the Indian Contract Act of 1872, and the Special Contract, which covers sections 124 through 239 of the same law. The many rules, terms, and circumstances for entering into a contract are discussed in the first portion, which contains general provisions. The second, which is a particular contract, discuss various contract kinds that we have already covered, including contracts of agency, bailment, guarantee, and pledge. Every guarantee assumes the risk of default, which varies based on the situation and can be more or lower in specific scenarios.¹

According to Section 126 of The Indian Contract Act, 1872, “a guarantee is a contract to carry out the promise or release the liability of a third person in the event of his default”². The individual providing the guarantee is referred to as the “surety,” the individual whose default the guarantee is granted is referred to as the “primary debtor,” and the individual to whom the guarantee is offered is referred to as the “creditor.”³

This means that a guarantee is a contract whereby the surety, a third party who is the second source of obligation, will discharge the liability if the principal debtor, who is the first source of liability, fails to pay the debt to the creditor.

Three different kinds of agreements can be signed between the principal debtor, the surety, and the creditor:

¹ Gupta, Deoswaroop. “Right of Surety in a Contract of Guarantee.” *Libertatem Magazine*, 6 Aug. 2021, <https://libertatem.in/blog/right-of-surety-in-a-contract-of-guarantee/>.

² Sec. 126, Indian Contract Act 1872

³ The Contract Act, 1872 | OF INDEMNITY AND GUARANTEE. <http://bdlaws.minlaw.gov.bd/act-26/chapter-details-86.html?lang=bn#:~:text=A%20%22contract%20of%20guarantee%22%20is,in%20case%20of%20his%20default.> Accessed 4 Apr. 2023.

Main Contract: A principal contract is an agreement established between the principal debtor and the principal creditor.

Secondary contract: A secondary contract is an agreement reached between the creditor and the surety.

Implicit contract: An implied contract has been made between the principal debtor and the surety.’⁴

Hence, we can understand that the character of Surety is very important in the above contract of guarantee. In this article, we will examine the various ways played by surety and how it had multiple functions in the legal order and law.

Two different types of guarantee contracts exist. It could be **written or verbal**. Yet, there must be consent between the parties for an agreement to form, which implies that all three parties must be aware of the contract. A guarantee contract is a promise to hold the primary debtor responsible for making payments to creditors or performing some other obligation. Who is initially required to pay or act if the principal debtor defaults?

Surety guarantees the creditor that, in the event of the primary debtor's default, they will fulfill either the pledge of the major debtor or the third party. The surety thereby guarantees the primary debtor's action to the creditor. It is feasible to see the surety's obligation as collateral for the principal debtor's obligations. A conditioned promise requires the guarantor to be held accountable if the primary debtor is unable to pay. The Act prioritizes the interests of the surety while attempting to protect the rights of all three parties involved in a guarantee arrangement.

HISTORY OF SURETYSHIP

As a result of the family's prior collective liability, it was long customary for family members to act as sureties for one another. During the Middle Ages, the vassal was also required to act as a pledge for his lord. Not shielding the surety from liability was a grave breach of trust that

⁴ LAWNN.COM. Contract of Guarantee, Kinds, Functions under the Indian Contract Act, 1872. 29 July 2019, <https://www.lawnn.com/contract-of-guarantee/>.

eventually justified challenging legal actions. Contemporary suretyship, much like the modern law of collateral security, evolved as legal theories advanced, proportionally to the improvement in debt payment assurance brought about by the expansion of the state's power and the improvement in trade relations due to commercial development.⁵

THE SURETY'S ROLE

According to the definition of surety, it is the act of placing one's confidence in another person while acting as their guarantee. The guarantor is fully aware that the money was granted based on his or her good faith, and in some cases, the guarantor's duty is quite similar to that of a trustee.⁶ Any services rendered or help provided by the creditor to the primary debtor's benefit may be sufficient compensation for the surety for providing the creditor with the guarantee. In a guaranteed contract, a guarantor is a debtor. The obligations of a guarantor to the creditors are limited by the terms of the guarantee agreement.

In legal words, surety is the promisor and the creditor is the promisee, and a debt (loan) is provided as a result of surety. The fundamental principle of the surety's liability is laid out in **S.128** of the Act. The last few paragraphs of **S.128** provide that, unless the contract provides otherwise, the surety's liability is coextensive with that of the principal debtor.⁷

As an example, the guarantor guarantees that C (the acceptor) will pay B for the bill of exchange (the creditor). C is dishonoring the bill. Presently, A, a surety, is responsible for the full amount of the debt and any applicable interest and fees.

S.126 of the Contract Act defines a guarantee as "third-person liability" in the event of any performance default; nevertheless, today, "guarantor is surety" and previous guarantees are not admissible as guarantees (**S.127**).

⁵ Osen, Carleigh. "The History of Surety and Suretyship." Surety1, 9 June 2016, <https://surety1.com/history-of-surety/>.

⁶ The Economic Times: Business News, Personal Finance, Financial News, India Stock Market Investing, Economy News, SENSEX, NIFTY, NSE, BSE Live, IPO News. <https://economictimes.indiatimes.com/defaultinterstitial.cms>. Accessed 4 Apr. 2023.

⁷ Sec. 128, Indian Contract Act 1872

A guarantee's primary purpose is to assist a person financially by enabling them to obtain a loan, credit for products, or employment. In the same way as in the “ancient case of **Birkmyr v. Darnell**,”⁸ “if two come to a shop and one buys, and the other lends him credit, promising the seller, “if he does not pay you, I will,” A “contract of guarantee” is a “kind of collateral promise to be liable for the default of another.” It is described as “a commitment to answer for the debt, default, or miscarriage of another” in English law.

A **2(d) exception is S.127** (consideration for assurance) (consideration of the promise). But, as noted in the case of **SBI v. Premco Saw Mills**⁹, previous consideration (one of the fundamental components of a guarantee) is not an exemption to **S.2(b) (promise) of the ICA**.

Rights to suretyship under S. 141 (every reimburse + promise both): According to the clause, “whether the surety knows it or not, the surety is entitled to the benefit of the security which the creditor has supplied against the principal debtor and the period when the contract of guarantee was entered into.”

WHAT THE SURETY'S RESPONSIBILITY INCLUDES

A surety is responsible for ensuring that the principal complies with all of the requirements of the agreement (such as state regulations for a particular line of business) and, in the event of a bond breach, must pay the obligee an amount that is less than or equal to the bond amount.

Co-extensive: The main principle that governs a surety's obligation is that it is shared or coextensive with the principal debtor. Only the whole sum for which the major debtor is liable applies to him. When the principal debtor admits fault, the surety is also affected and the statute of limitations against him is extended as a result.¹⁰

In **Lachman Joharimal v. Bapu Khandu and Others (1869)**¹¹, the Bombay High Court made it clear that the creditor did not need to exhaust all of his remedies before bringing legal action against the principal debtor. When a judgment is rendered against the surety, it may be enforced

⁸ Birkmyr v. Darnell, 1704, 1 Salkeld, 27

⁹ SBI v. Premco Saw Mills, AIR 1984 Guj 93

¹⁰ Edavan Kavingal Kelappan Nambiar vs Moolakal Kunhi Raman And Anr, (1956) 2 MLJ 544

¹¹ Lachman Joharimal v. Bapu Khandu and Others, (1869) 6 Bom HCR 241

in the same way as a declaration or judgment for any obligation owed by the parties or any unpaid debt.¹²

Condition Precedent- If there is a requirement that must be met before the surety can be held accountable, that requirement must be satisfied first. In part, **Section 144** is founded on the idea that a guarantee is only legitimate if the other party joins as a co-surety. If the other party does not participate, the creditor may not act on the promise.¹³

The defendant entered into a contract of guarantee in the **National Provincial Bank of England v. Brackenbury (1906)**.¹⁴ The defendant consented to the agreement under the condition that it be signed jointly and severally by three other parties. Nevertheless, one of the three individuals didn't even sign the guarantee contract. A contract condition was not satisfied, hence the court decided that no contract existed. The result was that the defendant was declared innocent.¹⁵

SURETY'S OBLIGATION

The responsibility of the guarantee is co-extensive with that of the principal debtor, according to **Section 128 of the ICA**, meaning that the surety is accountable to the same extent as the principal debtor. For instance, the surety is not responsible for the obligation if the primary debtor is not accountable for it for whatever reason. Additionally, the surety would also be freed if the creditor discharged the primary debtor for any reason.

The agreement also affects this portion. As a result, the terms of the agreement govern the surety's obligations, and they are not required to pay more than the principal debtor has agreed to.¹⁶

¹² Singh, Ganshyam. "The Liability of the Guarantor & Principle Debtors Are Co-Extensive and Not in Alternative - Industrial Investment Bank of India Ltd. Vs. Bishwanath Jhunhunwala - Supreme Court." IBC Laws, 31 Dec. 2016, <https://ibclaw.in/the-liability-of-the-guarantor-principle-debtors-are-co-extensive-and-not-in-alternative-industrial-investment-bank-of-india-lt-v-bishwanath-jhunhunwala-sc/>

¹³ Section 144 in The Indian Contract Act, 1872

¹⁴ National Provincial Bank of England v. Brackenbury, 1906 22 TLR 797

¹⁵ lawcirca. Surety's Liability Under the Indian Contract Act, 1857 - Law Circa. 23 Dec. 2020, <https://lawcirca.com/surety-s-liability-under-the-indian-contract-act-1857/>.

¹⁶ Surety's Liability, <https://incometaxindia.gov.in/Acts/Indian%20Contract%20Act,%201872/102120000000004429.htm>. Accessed 5 Apr. 2023.

RELEASE OF SURETY

All of the circumstances under which a surety may be discharged are explained in **Sections 133 to 139**. Because the surety is no longer liable under the guarantee, each of these parts can be referred to as the surety's rights. A guarantee contract is an agreement that can be terminated just like any other.

Section 133 of the ICA explains the release of surety by deviation. Exceptions to this Section: The surety is not released if a change to the contract is made without the surety's consent and is in the surety's favor. The confidence is not released if the change is negligible or negligible.

SURETY V. INSURANCE FIRMS

The debt is not covered by the surety; only the bond sum is. A surety is simply accountable for giving the obligee the time and resources needed to recover any losses that should have belonged to the principal.

In the end, as the main is responsible for paying back the surety for any claims paid, they must settle both the bond amount and the debt.

BANK GUARANTEE VS. SURETY

In contrast to bank guarantees, which cover any contract-related financial risk, a surety is accountable for the principal's performance guarantee.

Is it beneficial for the principal to have a surety?

Yes. When a surety bond is used, the principal benefits from a lower interest rate.

The vital role of the guarantee has also been recognized by numerous legal rulings. The Supreme Court ruled in an appeal brought by one **Ganga Kishun** who had served as a surety for a bank loan taken out by **Ganga Prasad**, who passed away before repaying it, that the guarantor of a loan is responsible for paying it if the debtor fails to pay it. After the major debtor's passing, Ganga

Kishun petitioned the Supreme Court to challenge the Uttar Pradesh government's decision to pursue collection of the loan arrears from him.¹⁷

According to the Supreme Court, the surety has no right to prevent the execution of the judgment against him until the creditor has exhausted all of its remedies against the principal debtor because it is the responsibility of the surety/guarantor to determine whether the principal debtor has made good on his obligations.

RIGHT OF SUBROGATION:

Section 140 of the Indian Contract Act of 1872 discusses a surety's rights about the payment or fulfillment of a guaranteed contract. It states that the surety is entitled to all the rights the creditor had against the primary debtor in cases where the guaranteed debt has become due or the principal debtor has defaulted, upon payment or performance of everything for which he is responsible¹⁸. According to the ruling in **Babu Rao Ramchandra Rao v. Babu Manaklal Nehmal**¹⁹, the surety's right would not become less coextensive with the creditor if he paid the creditor's debt if his obligation was coextensive with that of the principal debtor.²⁰

RIGHT OF INDEMNITY:

The implied obligation to indemnify the surety is discussed in **Section 145** of the Indian Contract Act of 1872. Every Contract of Guarantee contains an implied pledge from the principal debtor to reimburse the Surety for all costs that were legitimately paid to the creditor under the contract, but not for any amounts that may have been paid incorrectly.²¹ The guarantor paid off the creditor in the matter of **Shri Bisiwakarma Furniture Factory v. Santanu Sarkar**,²² and was then

¹⁷Ram Kishun And Others v. State Of Uttar Pradesh And Others, Supreme Court Of India, 2008 10 SCC 440

¹⁸ What Is Subrogation ... and Why Is My Contract Waiving It? <https://www.irmi.com/articles/expert-commentary/what-is-subrogation--and-why-is-my-contract-waiving-it>. Accessed 6 Apr. 2023.

¹⁹ Babu Rao Ramchandra Rao v. Babu Manaklal Nehmal (AIR 1938 Nag 413)

²⁰ "Babu Rao Ramchandra Rao v. Babu Manaklal Nehmal, Madhya Pradesh High Court, Judgment, Law,Casemine.Com." <https://www.Casemine.Com>, <https://www.casemine.com/judgement/in/5ac5e2f74a932619d903d90b>. Accessed 6 Apr. 2023.

²¹ Team, Finlawportal. "Rights of Indemnity Holder in a Contract of Indemnity." Finlawportal, 17 June 2022, <https://finlawportal.com/rights-of-indemnity-holder-in-a-contract-of-indemnity/>.

²² Shri Bisiwakarma Furniture Factory v. Santanu Sarkar, (2006) 5 AIR Kant (NOC) 762 (Jha) AIR 2006 Jhar 89

permitted to reclaim his indemnity, which also included the interest, from the principle. He was unable to support the principal's assertion that he had promised to pay without any such claim.²³

STANDING SURETY IN ENGLAND AND WALES

After a creditor has established a valid contract for surety, consideration of the remedies available to creditors under property law and under insolvency provisions has shown that the English courts are almost always strict in ensuring that the creditor can then pursue the debt, to the point of inciting bankruptcy and forcing the sale of the surety's assets, including their (family) home.

Therefore, the primary means of surety protection in England and Wales is general contractual vitiating elements, particularly undue influence.

SURETY BONDS IN AUSTRALIA

Surety bonds in Australia follow the market standard set by bank guarantees; because they are unconditional, the beneficiary is not required to establish a loss or default to claim the bond. Bonds for sureties are irrevocable and payable immediately. The majority of surety bonds range from 5 to 10% of the contract value, but this can change based on the conditions.

In contrast to insurance products, the client will reimburse the surety for any bond payments paid by the surety facility. The sureties consider the applicant's financial strength, operational capabilities, and track record of fulfilling contractual obligations when determining whether the applicant qualifies for a surety facility.

SURETY BONDS CAN BE A GAME CHANGER IF THE GOVERNMENT ADOPTS THEM IN FULL

Union Minister for Road Transport and Highways Shri Nitin Gadkari launched one of India's first-ever Surety Bond Insurance products from Bajaj Allianz.

²³ Shri Bishwakarma Furniture ... vs Santanu Sarkar And Anr. <https://legaldatabase.in/court/read/2369462>. Accessed 6 Apr. 2023.

The growth objective for India could be accelerated via surety bonds. They can also help the nation achieve its ambitious infrastructure goals for new roads, railroads, water systems, and renewable energy sources.

To decrease risk and add long-term value to projects, government agencies should adopt them quickly in this regard. The early indications are favorable.

The entire endeavor is commendable and a testament to India's pro-business agenda, from Finance Minister Nirmala Sitharaman's announcement, that surety bonds could replace bank guarantees to the interest shown by the roads ministry and the National Highways Authority of India. But now that the announcements and unveiling are over, we can get to the details.

Government departments might first provide precise deadlines for their organizations to adopt surety bonds.

If the right steps are taken, this might become one of the most important economic changes in India, giving millions of small and medium-sized businesses open access to financing.

The enormous potential of this tool to achieve the country's ambitious infrastructure target will soon be obvious as India starts down this new route of surety bonds. But, the devil, as they say, is in the details. And for a smooth and successful transition, the government needs to design and work out the details of this instrument.

SURETY IS NOT ENTITLED TO THE GOODS UNDER HYPOTHECATION

It should be emphasized that section 141 grants the surety the right to benefit from any assets held by the creditor. It includes circumstances in which the creditor has things that have been promised to him. The surety is released if he misplaces or sells the goods. If the commodities are hypothecated, they continue to be in his possession and there is no chance of him losing them or parting with them. Hence, the surety will not be released if the hypothecated commodities are lost without any fault on the part of the creditor. In other words, the surety cannot rely on section 141 in the case of hypothecated goods because the creditor does not possess the commodities in that situation.

CONCLUSION

We may conclude that a surety is someone who enters into a contract to pay liabilities if the principal debtor defaults after examining all the information regarding the rights of sureties and liabilities discussed above. Any judgment entered between the creditor and the principal debtor may also be applied to the surety as a surety with rights and obligations. Hence, unless otherwise specified in the contract of guarantee, the Surety's rights and obligations extend to the Debtor as well. If the creditor paid the full market value for the securities, forcing him to split them with the guarantee is unfair. Furthermore, the major debtor's duty to reimburse the surety forms the basis of the guarantor's claim to securities. It would be strange if the surety used these abilities to obstruct the creditor's attempts to collect on the debt. It is asserted that any claim made by the surety, whether based on section 140 or section 141, is superseded by the creditor's authority to withhold securities until the entire debt is satisfied. The debtor has no claim to the proportionate release of the securities by the loan repayment because the pledge is issued as a security for the entire loan. The conclusion that follows from the aforementioned considerations is that the surety is only entitled to the advantages of any security that the creditor holds against the principal debtor if the debt or liability owed by the principal debtor to the creditor has been fully paid or discharged.

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