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Co-extensive nature of Surety's Liability: A Contemplative Study

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Section 128 of the Indian Contract Act, 1872 demarcates the liability of the surety to be co-extensive. This simple one-liner section, even though distinctly straightforward, leaves a fissure for the interpretation of the same, when it comes to the precise application of the section. But is the nature of liability absolutely co-extensive? What is the justifiable and lawful action for creditors to take when using the surety? This article aims to dive into these questions to seek clarity regarding the obligations of surety towards the principal debtor and the creditor. The article also discusses briefly how this section can render the surety in a vulnerable space, further examining the rights and remedies available to the surety to remain on the more immune side of the spectrum. With precedent case laws as the catalysts, the author aims to elucidate the co-extensivity of surety's liability in different legal contexts and across different times in world history.

Keywords: *surety, liability, creditor, principal debtor, co-extensive.*

INTRODUCTION

The Indian Contract Act, 1872 lays down an intricate framework regarding the rights and liabilities of parties involved in a contract of guarantee. The essential parties in such a contract are the principal debtor, the creditor, and the surety. While defining the scope of each of these parties, the Contract Act also emphasizes their obligations towards each other. To begin with, it is important to annotate how the Act defines these terms. Section 126 of ICA, 1872[1] prescribes the foundation in the following manner: 'Contract of guarantee', 'surety', 'principal debtor' and 'creditor'- A 'contract of guarantee is a contract to perform the promise or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the 'surety'; the person in respect of whose default the guarantee is given is called the 'principal debtor', and the person to whom the guarantee is given is called the 'creditor'. A guarantee may be either oral or written. (While the Indian law considers oral guarantee, the English law renders only written guarantee to be valid.)

While the Indian law doesn't establish a specific section for the definition of the word guarantee, English law defines guarantee as follows: A guarantee is often assurance of a particular outcome or of something to be performed in a specified manner. The guarantor/surety, who makes the guarantee, assumes responsibility for paying another person's debts or for fulfilling another's responsibilities. It can be a promise for the execution, completion, or existence of something. It can also be a promise or an assurance attesting to the quality or durability of a product or service. So, a guarantee can be a 'promise to answer for the debt, default or miscarriage of another.

Further, Section 127 of ICA[2] prescribes what constitutes consideration in a contract of 'guarantee,' which is an essential element for the contract of guarantee to be valid. Section 127 Consideration for guarantee —anything done, or any promise made, for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee. It is important to note here that a contract of guarantee is a contract between three parties: principal debtor, creditor, and the surety. All these parties have certain rights and duties towards each other in case of a default. Section 128 of the ICA provides for the nature of surety's liability towards the creditor and principal debtor as well. This section dominates the nature of the course of transactions after default has occurred. The section elucidates,

[1] Indian Contract Act, 1872, s 126
[2] Indian Contract Act, 1872, s 127

Section 128: Surety's liability—the liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract. Merriam Webster dictionary defines the word co-extensive as having the same spatial or temporal scope or boundaries. On the occurrence of a default, surety becomes liable to the creditor in the same way as does the principal debtor. The surety here indirectly steps into the shoes of the principal debtor. Illustration[3]: A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonored 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.

Pollock and Mulla on Indian Contract and Specific Relief Act[4], further widen the scope of restrictions on surety's liability. It observes that surety's liability to pay the debt is not removed by reason of the creditor's omission to sue the principal debtor[5]. The creditor is not bound to exhaust his remedy against the principal before suing the surety, and a suit may be maintained against the surety though the principal has not been sued.[6] The explanation and extension of this can be found in a case explanation, in the following manner[7]: The judgment in Kashiba v Shripat Narshiv[8] says,

This section only explains the quantum of a surety's obligation when the terms of the contract do not limit it, as they often do. It does not follow, conversely, that a surety can never be liable when the principal debtor cannot be held liable. Thus, a surety is not discharged from liability by the mere fact that the contract between the principal debtor and creditor was voidable at the option of the former, and was avoided by the former. And where the original agreement is void, as in the case of a minor's contract in India, the surety is liable as a principal debtor; for in such a case the contract of the so-called surety is not collateral, but a principal contract. [Note: The entire paragraph from the judgment of the said case has been included herein.]

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[3] Rajesh Kapoor, *Avatar Singh's Contract & Specific Relief* (12th Edition, Eastern Book Company 2019)
[4] R Yashod Vardhan & Chitra Narayan, *Pollock and Mulla, The Indian Contract and Specific Relief Acts* (10th edition, Lexis Nexis 2019)
[5] *Ibid*
[6] *Ibid*
[7] *Ibid*
[8] *Kashiba v Shripat Narshiv* (1894) ILR 19 Bom. 697

HISTORY OF SURETYSHIP IN THE INTERNATIONAL CONTEXT

Before proceeding on to details about the nature of surety's liability, let us first have a look at the history of the contract of surety and the whether the nature of surety's liability was always co-extensive. William H.Loyd in his research paper titled the Surety' describes the history of suretyship as below[9]:

1. In primitive civilizations, there were no creditors because each of the transactions was considered final.

2. In case of a default, there was no surety. Debtor/defaulter would have to could hand over the property to fulfil liability, or perhaps with the privilege of redemption, the forerunner of the modern pledge and mortgage. He may surrender himself and work out the debt in quasi servitude.[10]

3. Initially, in case of a default, the family of the debtor was considered to be the surety. Nature thus could be said to be coextensive.

4. Modern surety developed through the progress of legal ideas, and commercial development. The moral emphasis is transferred to the promise, the debtor's liability becomes more and more conspicuous, and the surety is forced into the background, his liability becoming accessory.[11]

5. Fidejussio- A type of contract in the Roman Empire, as suretyship came into use. It mainly consisted of the debtor's heirs, and in case of discrete sureties, each was liable for the whole debt. These were the earliest advanced traces of the coextensive nature of surety's liability to the creditor. This practice also gave rise to the rights of the creditor against the debtor.

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[9] William H. Loyd, 'The Surety' (1971) 66 (1/2) University of Pennsylvania Law Review and American Law Register, 40–68, <https://doi.org/10.2307/3314322> accessed 26 February 2022
[10] *Ibid*
[11] *Ibid*

6. Mitchell, The Law Merchant, tells us that slowly this primary liability became secondary in law as in intention, although not without checks, for the skillful conveyancer will use the joint and several obligations to bind the parties together.[12]

Subsequently, Willis D. Morgan, in a research paper titled 'History and Economics of Suretyship' further elucidates the following points[13]:

1. The code of Hammurabi (circa 2250 B. C.), emphasized upon the city and governor being the surety in case of default from a citizen, with Sections 22 and 23[14] of this code that read:

- Section 22. "If a man has committed highway robbery and has been caught, that man shall be put to death."
- Section 23. "If the brigand is not captured, the man who has been robbed shall, in the presence of God make an itemized statement of his loss, and the city and the governor, in whose province and jurisdiction the robbery was committed, shall compensate him for whatever was lost."

Under the latter section, the city and the governor were placed in the position of a surety. But more than this, the section applies the insurance principle to contracts of suretyship; it substitutes group responsibility for individual responsibility[15].

2. Shakespeare's "Merchant of Venice" shows the wide use of the contract of surety in Elizabethan England. Antonio and Shylock - the main characters shared the contract of suretyship, with Bassanio as principal debtor.

3. In America, William L. Haskins, published a pamphlet entitled, "Considerations on the Project and Institution of a Guarantee Company, on a New Plan, with some general views on Credit, Confidence and Currency," in which the organization of a company named, "The New

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[12] *Ibid*

[13] Willis D. Morgan, 'History and Economics of Suretyship' (1927) 12 (2) Cornell Law Review, 153 <http://scholarship.law.cornell.edu/clr/vol12/iss2/2> accessed 26 February 2022

[14] Indian Contract Act, 1872, s 22 and 23

[15] *Ibid*

York Guarantee Co." was proposed. Haskins thus is to be given credit for having first conceived of the corporate surety, in its broader and more significant aspects.

4. Professor De Morgan of England played a crucial role in the establishment of the contract of surety in England in the mid-1800s.

5. In England, an act of Parliament in the year 1867 providing that the heads in the public service were allowed to accept the security only of companies that satisfied certain financial requirements, pioneered the establishment of corporate surety. This made the corporate surety was an object of government regulation and control. By the year 1875, the corporate surety had thus become an established institution.

SIGNIFICANT CASE PRECEDENTS

Following are some of the case laws that elucidate the co-extensive nature of surety's liability in practical ways. These cases also prescribe the restrictions and boundaries on co-extensive nature in a reasonable manner.

Liability of surety is co-extensive but primarily of that of the debtor: Maharaja of Benaras v Har Narain Singh[16]: He is liable for the whole of the amount and he is liable for no more.[17] Liability of surety is co-extensive and primarily that of the principal debtor. C.J Stanley affirmed that the liability of the surety is strictly confined to the limitations of dues which he promised to give a surety of. This implies that surety cannot be held more liable than the principal debtor himself. Thus, the guarantor of rent was held not liable for interest on rent because the principal debtor himself was not liable.[18]

A surety is liable for interest and charges unless mentioned otherwise: Indian Over Seas Bank v G Ramulu[19]: Indian Over Seas Bank the creditor filed a case on G Ramulu - the borrower and two other defendants who were the sureties. The appellant believed that sureties were liable to

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[16] *Maharaja of Banaras v Har Narain Singh* (1906) ILR 28

[17] Rajesh Kapoor (n 3)

[18] *Ibid*

[19] *Indian Over Seas Bank v G Ramulu (*1999) 2 ALD 104

pay the amount of interest and other charges. The court found this submission valid and established that surety is liable for principal amount and interest as well as the charges incurred in enforcing the liability. The court held that the trial court erred in decreeing the suit against the surety for only a principal amount excluding the interest and costs.[20]

Surety's liability is restricted to only the terms mentioned in the contract: Central Bank of India v Virudhunagar Steel Rolling Mills Ltd[21]: Surety is liable only for the terms of the guarantee mentioned in the contract of guarantee, and no more liable than that. Central Bank of India tried to recover from guarantor liability due to pre-existing debts and this term was not mentioned in the guarantee that was itself drafted by the bank. The Supreme Court however pointed out this does not mean that no liability can be fastened upon a guarantor for pre-existing debts.[22] Such liability can be fastened upon the guarantor only and only if it is mentioned in the contract of guarantee.

A surety is not liable after the expiry of time: Amal Krishna Ray v Bank of Baroda[23]: A guarantee was given to a bank for the borrower's loan. The surety gave notice to the bank for withdrawal of his guarantee. The contract of guarantee carried a provision to the effect that it would cease to exist after the expiry of three months from the date of the notice. The court said that the guarantor could not be held liable after such expiry of time.[24]

Surety's liability is co-extensive but not alternative: In Jagannath Ganeshram Agarwala v Shivnarayan Bhagirath[25]: The first defendant retains that as the plaintiff had received half the amount in cash and the shares of the mill company, he was discharged from his debt and that no obligation of the surety survived. It was argued on behalf of respondent no. 1 that if the debt is considered alternative, conditions having been satisfied by one party, the debt did not survive. The bench of Bombay High Court held that the liability of the surety is coextensive,

[20] Rajesh Kapoor (n 3)
[21] *Central Bank of India v Virudhunagar Steel Rolling Mills Ltd* (2016) 2 CHN 98
[22] *Ibid*
[23] *Amal Krishna Ray v Bank of Baroda* (2014), AIR179 (Ori)
[24] *Ibid*
[25] *Jagannath Ganeshram Agarwala v Shivnarayan Bhagirath* (1940) 42 BOMLR 451

but is not in the alternative. Both the principal debtor and the surety are liable at the same time to the creditors[26].

Liability of surety isco-extensive and secondary: There are three parties in a contract of guarantee - the creditor, the principal debtor, and the surety. In a contract of guarantee, there are two contracts; the Principal Contract between the principal debtor and the creditor as well as the Secondary Contract between the creditor and the surety. The contract of the surety is not contracted collateral to the contract of the principal debtor but is an independent contractor. Liability of surety is secondary and arises when the principal debtor fails to fulfil his commitments. Even an acknowledgment of the debt by the principal debtor will bind the surety.

Conditions for enforcing liability: Swan vs Bank of Scotland 1836, it was held that a contract of guarantee is a tripartite agreement between the creditor, the principal debtor, and the surety.

- The distinct promise of surety - There must be a distinct promise by the surety to be answerable for the liability of the Principal Debtor.
- Liability must be legally enforceable - Only if the liability of the principal debtor is legally enforceable, the surety can be made liable. For example, a surety cannot be made liable for a debt barred by the statute of limitation.
- Consideration - As with any valid contract, the contract of guarantee also must have a consideration. The consideration in such a contract is nothing but anything done or the promise to do something for the benefit of the principal debtor.

Contract of surety is collateral and independent: Tikki Lal v Komalchand[27]: The surety, in this case, had presented a minor to be of full age and on such misleading presentation had induced the plaintiff to part with money to the minor. The Judge of the case treated it as one not merely of a guarantee but where the surety had entered into a primary contract on which he was liable. He laid down that surety had entered the contract and made them enter into this

[26] *Ibid*
[27] *Tikki Lal v Komalchand* AIR 1940 Nag. 327

transaction. As per the terms mentioned in the contract, the sureties must under the terms, compensate the plaintiffs. The suretyship contract is collateral and almost an independent contractor and can be enforced.[28]

Surety's liability cannot be wiped out: Nanda Dulal Sen v Rao & Sons[29]: It was held that the decree against the surety would not be executed till the principal debtor paid off the dues by installments allowed by the court and thus the liability of surety wasn't wiped out.[30]In all proceedings against a debtor, his sureties are a proper party.[31]

Surety's liability in some instances is joint and several: Industrial finance corporation of India v P.V.K. Papers Ltd[32]: The guarantors P.K. Tiwari and V.K. Tiwari were not made a party to the contract of loan repayment without any logical explanation. Industrial Finance Corporation of India a public financial institution filed a petition before the court for seeking relief on the sale of properties of PVK Papers Limited. The principal debtor is the Company known as 'PVK Papers Limited'. The guarantors are its directors, in their individual capacity. While referring to Nanda Dulal's judgement[33], the bench declared that it is because the liability is joint and several.[34] The IFCI, when bringing this action into court ignored the aspect of the identity of the guarantors.[35]

Surety as the secondary principal debtor cannot take advantage of its own default: Chokalinga v Dandayu-thapani[36]: The court laid down that plaintiff had transacted the money to the defendant i.e., the principal debtor in this case on the faith of the guarantee i.e., the second defendant herein. There is an equitable rule that the moment the principal debtor defaults in the payment or where the subject matter of the guarantee is the conduct of the principal debtor, or there is some breach of duty by the principal debtor causing damage to the

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[28] *Edavan Kavingal Kelappan Nambiar v Moolakal Kunhi Raman and Anr.* (1956) 2 MLJ 544
[29] *Nanda Dulal Sen v Rao & Sons* (1972) 38 CLT 959
[30] Rajesh Kapoor (n 3)
[31] *Ibid*
[32] *Industrial finance corporation of India v P.V.K. Papers Ltd* AIR 1992 All 239
[33] *Ibid*, 30
[34] *Ibid,* 31
[35] *Ibid*
[36] *Chokalinga v Dandayuthapani Chettiar* AIR 1928 Mad 1262

holder of the guarantee, then immediately the surety becomes liable as if he were himself the principal debtor.[37]It was also established that surety cannot take advantage of its own default to escape the liability towards the creditor.[38]

A surety is liable to see that principal debtor performs his obligation: Swaminatha v Lakshmana[39]: Surety is not entitled to say that the creditor must exhaust his remedies as against the debtor nor is he entitled to notice that the principal debtor has defaulted, for according to law it is the duty of the surety to see that the principal debtor pays or performs his obligation.[40]The fourth defendant in this case, after referring to the promissory note made by the third defendant on the same day, entered into a contract of guarantee, and this contract was renewed by him three years later. The question was posed before the bench as to whether the fourth defendant can be made liable for the amount mentioned in the promissory note in the circumstances of the case.

A surety is liable to provide security on creditor's demand: E.P. George v Bank of India AIR[41] : The plaintiff- Bank of India filed a suit for realization of amounts due from the defendants. The plaintiff wished to establish joint and several liabilities of the surety that was the defendant in the case. Bench ascertained that the liability of a surety exists only on default by the principal debtor. But it is also an obligation created by the contract for the surety to discharge the debt in case default is committed. The court considered the definition of debt in a twofold manner i.e., 1. Debt arising in the future. And 2. Debt in present. A guarantor is also a debtor and if the creditor is demanding security from the surety also, he should be able to provide security by an equitable mortgage of his property.[42]

The surety can be sued directly without first suing the principal debtor: Central Bank of India v Antony Hardware Mart[43]: Court established that it is not mandatory to give notice to the

[37] *Ibid*
[38] *Ibid*
[39] *Swaminatha v Lakshmana* AIR 1935 Mad 748
[40] *Ibid*
[41] *E.P. George v Bank of India* AIR 2001 Ker 107
[42] Rajesh Kapoor (n 3)
[43] *Central Bank of India v Antony Hardware Mart* (2006) 3 CTC 285 (Mad)

surety before filing a case on him. A decree can be executed against the surety without first proceeding against the principal debtor.[44]Central Bank of India acted as a financial creditor for Mr. S. Kandaswamy. Proprietor of Antony Hardware Mart was the surety for Mr. S. Kandaswamy- who was later declared insolvent by Madras High court. The grant of cash credit facility from CBI to the debtor was unknown to the surety and thus the defendant claimed that suit against surety by the plaintiff was not maintainable.

CASES WHEREIN LIABILITY CAN BE MADE CONDITIONAL AND SUIT AGAINST SURETY:

When there is a condition set for surety's liability to come into the picture, the surety cannot be held liable unless that condition is fulfilled. This phenomenon is called 'condition precedent.' Section 144 of the Indian Contract Act 1872 recognizes this section partially by defining the condition of co-surety. This can help the surety make the guarantee conditional. However, it should be significantly noted that where the liability is otherwise unconditional, the court cannot of its own introduce a condition into it.[45] In this case, the Patna High Court decreed that the bank shall claim the guarantee only after it had exhausted all its remedies against the principal debtor, conditioning that proceeding against surety can only begin after exhausting remedies against the debtor. The Supreme Court, while overruling this decision laid down such conditions by courts to defeat the very purpose of the term 'guarantee.' Even though the liability of surety and that of the principal debtor are co-extensive, a suit can be filed against each of them alone, separately, and without necessarily suing both the parties together. In Union Bank of India v Noor Dairy Farms[46], the bench declared that creditors' suit against the principal debtor alone cannot be rejected on the ground that he has not joined the guarantor as a defendant to the suit.[47] On the other end, in Narasimahaiah v Karnataka State Financial Corporation[48], the court articulated that a suit against surety without even impleading the

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[44] *Ibid*, 43

[45] *Bank of Bihar Ltd v Damodar Prasad* AIR 1969 SC 297

[46] *Union bank of India v Noor Dairy Farms* (1997) 3 Bom. CR 126

[47] *Ibid*, 43

[48] *Narasimahaiah v Karnataka State Financial Corporation* AIR 2004 Kant 46

principal debtor is maintainable.[49] In cases where the principal debtor has died, a suit against him was found void from the inception, but the suit against surety could still proceed. Therefore, suits against the principal debtor and the surety respectively are not to be considered interdependent in nature. The creditors can exhaust all the remedies against the principal debtor by taking possession of his mortgaged property but the same cannot be done against the surety[50]. Without notice to the guarantor, creditors cannot take possession of his mortgaged property. The reason is that the liability of the guarantor is secondary and arises only when the borrower fails the payment i.e., a default occurs on behalf of a corporate debtor[51].

CONCLUSION

Section 128 of the Indian Contract Act, 1872 holds significant cruciality for the obligations of the surety. Even though it sometimes may leave the surety in a vulnerable position, it renders essential to not defeat the very purpose of the word: surety. The surety also possesses the right to make the guarantee conditional. This lawful balancing of obligations and rights situates the surety in an equitable orientation. The co-extensive nature of surety's liability is not pondered upon as unconditionally absolute, as strongly stipulated by case precedents. There may be a substantive lacuna regarding surety's liability in some instances but there are remedies to nullify such grey arenas. Surety benefits both the principal debtor and the creditor as well. It acts as a hypotenuse in a triangular relational structure of principal debtor, creditor, and itself.

[49] *Ibid*
[50] *Ibid*
[51] *Ibid*