

# “Decoding Contracts of Guarantee: A Critical Analysis of Sections 130, 143, and 145 of the Indian Contract Act”

*by*

**Lakshita Kanwar**

Symbiosis Law School,

Pune, India.

***Abstract:*** This paper critically examines key provisions of the Indian Contract Act, 1872, specifically those related to contracts of guarantee. Focusing on Sections 130, 143, and 145, the study analyses through literal interpretations, identification of legislative loopholes, and discussions of landmark case laws, the paper explores the ambiguities and practical challenges within these provisions. The findings highlight the need for greater clarity in the law to safeguard the interests of sureties and promote equitable enforcement of guarantee contracts in India.



Journal of Multi-Disciplinary  
Legal Research

## Introduction

A contract of guarantee, according to section 126<sup>1</sup> of the Indian Contract Act, is a contract to perform a 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”. The function of a contract of guarantee is to enable a person to get loan, or goods on credit or an employment. Guarantee is the second pocket to pay if the first is empty.

### Section 130<sup>2</sup>, Indian Contract Act, 1872.

*Revocation of continuing guarantee.*

*“A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.”*

### Literal Interpretation of the provision:

The section mentions ‘*A continuing guarantee*’ may at ‘*any time*’ be ‘*revoked by the surety*’, as to ‘*future transactions*’, by ‘*notice to the creditor*’. Here the provision clearly specifies that it is applicable only to a continuing guarantee (under Sec 129<sup>3</sup> ICA) i.e. reversal interpretation and hence, if a normal guarantee contract is revoked, it will lead to breach of the contract. This is so because in a continuing guarantee, every transaction is an independent contract which makes the surety irrevocably liable but he may free himself from the future liability. The section also mentions that the guarantee may be annulled at any point of time by the surety with a notice to the creditor and that this revocation is apposite for future transactions only i.e. prospective transactions. And the surety shall continue to remain liable for transactions entered into prior to the notice.

---

<sup>1</sup> Indian Contract Act, 1872, § 126 (India).

<sup>2</sup> Indian Contract Act, 1872, § 130 (India).

<sup>3</sup> Indian Contract Act, 1872, § 129 (India).

### **Loopholes and Shortcomings:**

- 1.) Firstly, the provision mentions about the obligation to notify the creditor, while notice may or may not be given to the principal debtor. This concealment of revocation may lead to wrongful loss to the debtor because he may misconceive that there is second pocket to pay for his defaults.
- 2.) Secondly, there is no specification made about the mode of notice. And if it to be in written mode, then why there is confinement of revocation in one mode only when making of the contract can be done in either of the modes.
- 3.) Thirdly, there is no mention about the acceptance methodology i.e. acceptance on receiving or on communication.
- 4.) Fourthly, the provision once is referring about the discharge of duty of surety while at the other hand it also refers about the right of the surety in case of continuing guarantee, hence mentioning the inverses.

### **Examples and Case laws:**

(a) The example in the provision is based on *Offord v. Davies*<sup>4</sup> where the surety guaranteed repayment of bills to be discounted by the Creditor for the Debtor, up to the amount of \$600, for a period of one year. The Surety had revoked their guarantee before any bill was discounted, the Creditor continued to discount the bills. When the Debtor defaulted on payment, it was held that the Surety was not liable for the bills discounted after the revocation of the guarantee. Now the example does not clarify about the amount of liability surety will have if principal debtor makes partial payment or settles the debt later.

(b) A guarantees to B, to the extent of 10,000 rupees, that C shall pay all the bills that B shall draw upon him. B draws upon C. C accepts the bill. A gives notice of revocation. C dishonours the bill at maturity. A is liable upon his guarantee.

Now the example here assumes A is automatically liable when C dishonours the bill. But under Section 128<sup>5</sup> (Surety's liability), the surety's liability is co-extensive with that of the

<sup>4</sup> *Offord v. Davies*, (1862) 142 Eng. Rep. 1336 (C.P.).

<sup>5</sup> Indian Contract Act, 1872, § 128 (India).

principal debtor (here, C) and if C has any valid defence like fraud<sup>6</sup>, coercion<sup>7</sup>, or illegality in the bill transaction, A might not be liable either. Hence does not clarify whether C had any valid defence to refuse payment.

Here, the court takes a strict interpretation and since the bill was drawn and accepted before revocation, A remains liable.

(c) In the case of *Wingfield vs De St Cron*<sup>8</sup>, it was held that a person who guaranteed the rent payment for his servant but revoked it after the servant left his employment was not liable for the rents after revocation.

(d) In the case of *Sita Ram Gupta v Punjab National Bank*<sup>9</sup>, the surety tried to revoke the guarantee before the amount was advanced to the principal debtor. However, the contract contained a clause stating that the guarantee is of a continuing nature and cannot be cancelled or revoked. The court held that the surety had waived his right to revoke the contract and hence can't revoke the guarantee now.

### Research Question:

1.) Will the surety be discharged of his liabilities if the principal debtor becomes insolvent? In *State Bank of India v. Indexport Registered*<sup>10</sup>, the court held that a bank guarantee is an independent and autonomous contract, meaning that the bank's liability under guarantee is not affected by principal debtor's insolvency, liquidation or other events.

2.) Will the surety be discharged of his liabilities if the contract is that of a minor because the minor's contract is void ab initio?

In the case of *Coutts and Co vs Brown Lecky*<sup>11</sup>, the bank had given a loan to an infant by means of an overdraft which had been guaranteed by the second and third defendants. On default, the bank sued both the sureties. Justice Oliver observed that according to section 1 of the Infants

<sup>6</sup> Indian Contract Act, 1872, § 17 (India).

<sup>7</sup> Indian Contract Act, 1872, § 15 (India).

<sup>8</sup> *Wingfield v. De St. Croix*, (1919) 46 I.A. 351 (P.C.).

<sup>9</sup> *Sita Ram Gupta v. Punjab Nat'l Bank*, (2008) 5 S.C.C. 711 (India).

<sup>10</sup> *State Bank of India v. Indexport Registered*, (1992) 3 S.C.C. 159 (India).

<sup>11</sup> *Coutts & Co. v. Browne-Lecky*, [1946] 2 All E.R. 207 (K.B.).

Relief Act 1874<sup>12</sup>, the minor's contract was void ab initio. Therefore, there was no question of debt, default or miscarriage which could be claimed from the sureties as a liability. Since the contract itself was void, the guarantee to it did not hold any validity as well.

In India, in the case of *Kashiba Ben Narsapa Nikade vs Narshiv Sripat*<sup>13</sup>, a 17-year-old Hindu widow had entered into a contract that had been guaranteed by the second defendant. The Bombay High Court held that a surety of a bond passed by a minor for money borrowed for purpose of litigation not found to be necessary, is liable to be sued on it whether the contract of minor is considered void or voidable. If the debt is void, the surety is liable not as the guarantor but as the principal debtor himself.

3.) If the liability of the principal debtor is reduced by a statute, does the liability of the surety get reduced as well?

In *Aypunny Nani vs Devassy Kochouseph*<sup>14</sup>, the court interpreted that in cases of debt waiver, the principal debtor would be relieved from all liabilities but the surety will be required to pay the creditor and hence could seek reimbursement from principal debtor according to section 144<sup>15</sup> of the Indian Contract Act, thereby nullifying the ameliorate provisions of the indebted agriculturalists. Thus, the statutory reduction of the principal debtor's liability will operate as a pro tanto reduction of the surety's debt.

### **Section 143 of Indian Contract Act<sup>16</sup>**

*Guarantee obtained by concealment invalid.*

*“Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances, is invalid.”*

#### **Literal Interpretation of the provision:**

The section states 'any guarantee' meaning that this section is applicable to all forms of guarantee either normal or continuing. The section also mention 'creditor has obtained' which means that concealment of facts should be done by creditor only, concealment of facts by

<sup>12</sup> Infants' Relief Act 1874, 37 & 38 Vict. c. 62, § 1 (UK).

<sup>13</sup> *Kashiba v. Shripat Narshiv*, (1894) I.L.R. 19 Bom. 697 (India).

<sup>14</sup> *Aypunni Mani v. Devassy Kochouseph*, AIR 1966 Ker. 203 (India).

<sup>15</sup> Indian Contract Act, 1872, § 144 (India).

<sup>16</sup> Indian Contract Act, 1872, § 143 (India).

debtor does not invalidate the contract. ‘By means of keeping silence’ signify not speaking where there is duty to speak i.e. withholding of information. ‘Material circumstances’ here means that the information so concealed should be of such relevance that it should affect surety’s decision to enter into guarantee contract.

### **Loopholes and Shortcomings:**

- 1.) Firstly, the provision only talks about concealment of fact by the creditor, thereby validating withholding of information by debtor.
- 2.) Secondly, fraud under General Contract law is customized as per the requirements of the provision. There is concretization of the consequence hence not giving surety the discretion to continue the contract when fraud is committed.
- 3.) Thirdly, the provision uses the word ‘invalid’ which is not defined in the Indian Contract Act leading to confusion and ambiguity in its interpretation.
- 4.) Fourthly, the provision does not assign any responsibility to surety to conduct due diligence. Surety is given the benefit of the statute of fraud, and the court has striven to accord him some protection against the principle embodied in the maxim caveat emptor to which a promisor is normally exposed.

### **Examples and Case laws:**

- 1.) The example mentioned in the provision is similar to case of London General Omnibus Co. v. Holloway<sup>17</sup>, where a person was invited to guarantee an employee, who was previously dismissed for dishonesty by the same employer. The surety guaranteed employee’s fidelity and the employee later embezzled funds. The court held that the surety was not liable as he was misled about the true nature of employee’s trustworthiness and employer did not disclose the prior dishonesty. *“The surety believed that he was making himself answerable for a presumably honest man, not for a known thief.”* The court also stated that if the creditor is aware of circumstances affecting the risk, he should make the surety equally aware.

- 2.) 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 five rupees per ton beyond the market price,

---

<sup>17</sup> London Gen. Omnibus Co. v. Holloway, [1912] 2 K.B. 72 (Eng.).

such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

Here, B and C made a secret deal that B would pay ₹5 more per ton, and that extra would go toward an old personal debt between them. The true financial arrangement was i.e. the overpayment and the real purpose behind it, was intentionally concealed from A thereby hiding an information which could have potentially altered A's entering into the contract. Therefore, due to active concealment of material fact, the contract was deemed invalid.

3.) In the *Nottingham Hide Co vs. Bottrill*<sup>18</sup> case, it was emphasised that the determination of whether a guarantee is a continuing guarantee or not depends on the specific facts, circumstances and intentions of each case. Lord Atkin, in his opinion, which was accepted by the other members of the House, contented himself with stating the problem. " There may be a question whether in the formation of a contract of guarantee there is an obligation on the promisee to make a disclosure of material facts which would not exist in the formation of an ordinary contract." He then observed that there are two views as to the nature of this duty. According to one view, it is a positive duty to disclose material facts, while according to the other view, there is implied a representation that the transaction to be guaranteed has no unusual characteristics of which the guarantor is not aware. \_\_\_\_\_

4.) In *Co-operative Commission Shop Ltd v. Udham Singh*<sup>19</sup>, defendant agreed to be the surety for a transaction involving a shop. The key issue was whether the shop had a duty to disclose all material fact to surety before he entered into the guarantee agreement. The court determined that by failing to disclose material facts, the Shop had induced Udham Singh into the guarantee, and therefore, he was discharged from his liability.

5.) *Bank of Scotland v Morrison*<sup>20</sup> highlights the distinction between cautionary and fidelity guarantees and the duty of the creditor to communicate suspicions to the cautioner. The Court found that the bank's suspicions of forgery did not impose a duty to disclose to the cautioner. Despite strong suspicions, without concrete evidence of forgery, the bank was not obligated to inform the cautioner.

---

<sup>18</sup> *Nottingham Hide Co. v. Bottrill*, (1873) 3 Q.B.D. 1 (Eng.).

<sup>19</sup> *Co-operative Comm'n Shop Ltd. v. Udham Singh*, AIR 1944 Lah 424 (India).

<sup>20</sup> *Bank of Scotland v. Morrison*, [1911] S.L.R. 527 (Scot.).

6.) In *Shrinivas Shankar v. Raghukul Shahkari Griharachana Sanstha Maryadit*<sup>21</sup>, the court held that even though guarantee is not a contract of utmost faith (*uberrimae fidei*), yet as it is a contract, all the elements of contract must be fulfilled.

### **Research Question:**

- 1.) The intersection of guarantee law and fiduciary law i.e. interference of fiduciary relationship in the concealment of fact under section 143<sup>22</sup>.
- 2.) How does concealment of fact applies when there is withholding of facts, not due to human agency, rather due to lack of algorithm transparency i.e. generating contract using AI.

### **Section 145<sup>23</sup> of Indian Contract Act**

*Implied promise to indemnify surety.*

*“In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety, and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but, no sums which he has paid wrongfully.”*

### **Literal Interpretation of the provision:**

The provision creates ‘Subrogation’, allowing the insurer to step into the policyholder's shoes and seek reimbursement from the at-fault third party. The ‘every contract of guarantee’ in the provision means parties cannot create exception to this rule even if they intend to do so in spite of the freedom of parties to contract. There is no written contract rather law assumes that there is prior meeting of minds regarding the reimbursement of rightful sums to be paid to surety by principal debtor i.e. implied contract. Later the second dimension i.e. promise in the form of implied contract is signified. In the provision, there is reciprocity of contract, meaning there is both creation of duty and specification of right. There is a distinction made between rightful payment and wrongful payment. Rightfully paid here implies those payments made as per the terms of the guarantee or under the legal obligation and not in excess of liability. The provision creates a duty chain between the parties of the tripartite guarantee structure.

---

<sup>21</sup> *Shrinivas Shankar Potnis v. Raghukul Sahakari Griharachana Sanstha Maryadit*, AIR 2010 Bom. (NOC) 1169.

<sup>22</sup> Indian Contract Act, 1872, § 143 (India).

<sup>23</sup> Indian Contract Act, 1872, § 145 (India).

**Loopholes and Shortcomings:**

- 1.) Firstly, there is no clarification regarding what is a ‘wrongful payment’ leading to ambiguity.
- 2.) Secondly, there is no clarity regarding the question whether the surety can claim interest, litigation costs or penalties incurred in recovering the payment from principal debtor.

**Research Question:**

- 1.) What happens when the principal debtor becomes insolvent, is he relieved from his liability to reimburse the surety?

When the principal debtor becomes insolvent<sup>24</sup>, surety can still claim reimbursement but in practice, surety can only recover from the debtor through the insolvency process.



Journal of Multi-Disciplinary  
Legal Research

---

<sup>24</sup> Insolvency and Bankruptcy Code, 2016, No. 31, Acts of Parliament, 2016 (India).

## References

- 1.) <https://www.ijirmeps.org/papers/2021/4/1164.pdf>
- 2.) Mulla, D. F., *The Indian Contract Act and Specific Relief Act*, LexisNexis
- 3.) <https://ijalr.in/wp-content/uploads/2022/09/Article-18.pdf>
- 4.) <https://lawbhoomi.com/continuing-guarantee/>
- 5.) R. S. Narula, “*Surety’s Liability and Rights under Indian Law*”, *Journal of Indian Law and Society*, 2020
- 6.) <https://mail.legalserviceindia.com/legal/article-3950-continuing-guarantee-nature-and-modes-of-revocation.html>



Journal of Multi-Disciplinary  
Legal Research