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Megha Middha, is working as an Assistant Professor of Law in Mody University of Science and Technology, Lakshmangarh, Sikar (Rajasthan). She has an experience in the teaching of almost 3 years. She has completed her graduation in BBA LL.B (H) from Amity University, Rajasthan (Gold Medalist) and did her post-graduation (LL.M in Business Laws) from NLSIU, Bengaluru. Currently, she is enrolled in a Ph.D. course in the Department of Law at Mohanlal Sukhadia University, Udaipur (Rajasthan). She wishes to excel in academics and research and contribute as much as she can to society. Through her interactions with the students, she tries to inculcate a sense of deep thinking power in her students and enlighten and guide them to the fact how they can bring a change to the society

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Assistant professor of Law

Mrs.S.Kalpana, presently Assistant professor of Law, VelTech Rangarajan Dr. Sagunthala R & D Institute of Science and Technology, Avadi. Formerly Assistant professor of Law, Vels University in the year 2019 to 2020, Worked as Guest Faculty, Chennai Dr. Ambedkar Law College, Pudupakkam. Published one book. Published 8 Articles in various reputed Law Journals. Conducted 1 Moot court competition and participated in nearly 80 National and International seminars and webinars conducted on various subjects of Law. Did ML in Criminal Law and Criminal Justice Administration. 10 paper presentations in various National and International seminars. Attended more than 10 FDP programs. Ph.D. in Law pursuing.



Avinash Kumar



learning.

Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC - NET examination and has been awarded ICSSR - Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and

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VALIDITY OF PAST CONSIDERATION IN
GUARANTEE CONTRACTS:
ANALYZING THE CONFLICT BETWEEN SECTION 127
AND ITS THIRD ILLUSTRATION of ICA, 1872

AUTHORED BY: AMRUTA VENKATACHALAM

Abstract

The inception of contract law in India dates back to 1872, but certain provisions remain a subject of contention and require clarification in light of the ever-evolving global economy. One of the key issues under debate pertains to the acceptance of past considerations in guarantee contracts. The dispute revolves around Section 127¹ of the Indian Contract Act, which defines the concept of consideration in guarantee contracts. This debate has persisted for years, with various courts offering differing interpretations regarding the validity of past considerations. The wording of Section 127, which employs the phrase "anything done," initially suggests that actions taken in the past can constitute valid consideration for a guaranteed contract.

However, this seems to contradict its third illustration, which excludes the applicability of past considerations in guarantee cases. This glaring inconsistency within the section has led to different opinions among Indian courts. Some decisions rely primarily on the language of the main section itself, while others place significant weight on its third illustration. Still, some maintain that illustrations should not restrict the interpretation of the main section. This paper seeks to discuss the varied interpretation of consideration in guarantee contracts through a series of judgments that have tried to uphold consistency beyond the conflict under Section 127 of ICA, 1872.

¹ Section 127, Indian Contract Act, 1872.

INTRODUCTION:

A contract of guarantee is a special contract as given under Section 126² of the ICA under which one person promises to discharge the liability of a third person in case of a default in payment. The three parties to a contract of the guarantee are the 'Surety' who promises to guarantee; the 'Principal Debtor' whose liability is to be discharged; and a 'Creditor' to whom the guarantee is given, in the form of a tripartite contractual obligation. Therefore, there is a contract of guarantee between the surety and the creditor and a contract of indemnity between the Principal Debtor and the surety. As a general principle of the Law of Contracts, some consideration must support every contract. The same applies to a contract of guarantee³. The wording of Section 127 of the Indian Contract Act, 1872 which uses the phrase "anything done" gives one the impression that anything done in the past will constitute a valid consideration for a contract of guarantee. However, it is in contradiction to its third illustration which makes past consideration inapplicable in case of guarantee.

Consideration for a guaranteed contract is given in Section 127 of the Indian Contract Act. Any commitment made by the creditor in favor of the principal debtor serves as a valid consideration for the surety. According to this section, it doesn't matter whether or not there is any advantage for the surety. For example, if the creditor agrees to purchase goods from the principal debtor, this constitutes adequate consideration for the surety, even if it doesn't benefit the surety.

Dispute over consideration:

There has been a dispute over whether past consideration will be considered valid consideration under Section 127 of ICA. There is some disagreement on whether the benefit must be provided at the time of guarantee execution or if a previous benefit can also qualify as a valid consideration for upholding such an arrangement. It has been noted that "no court of common law has ever stated that there must be consideration directly exchanged between the parties providing and receiving the guarantee. It suffices if the individual for whom the guarantor becomes surety receives a benefit, or the person to whom the guarantee is given experiences inconvenience, as an incentive for the surety to become a guarantor for the principal debtor"⁴.

² Section 126, Indian Contract Act, 1872.

³ Janaki Paul v Dhokar Mall Kidarbux, (1935) 156 IC 200.

⁴ Marley v Boothby (1825) 3 Bing 107

This issue arises due to the ambiguity in the terms 'anything done' and the example 'c' in the section. It becomes evident from illustration c that if credit has already been extended to the principal debtor, and there is no other consideration at the time the surety agrees to provide the guarantee, then the guarantee contract is void. However, the word 'anything done' is often construed to have a wide enough meaning to not restrict the ambit of consideration to be contemporaneous for a valid contract.

Interpretation of Section v. Illustration: Diverging Judgements

Section 127 of the Indian Contract Act (ICA) specifies that "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." This section underscores the necessity of consideration in a contract of guarantee, similar to any other contract, and establishes that a direct exchange of consideration between the creditor and the surety is not mandatory. Instead, the benefit provided to the principal debtor serves as sufficient consideration for the surety. This was held in *Chakhan Lal v. Kanhaiya Lal*⁵, where there was sufficient consideration for the undertaking of suretyship for the whole sum to render it valid even though the surety may not have benefited from any of the advances made. This provision validates that any action taken by the creditor in the past, before the guarantee is given, is also a valid form of consideration. The inclusion of the term 'done' in Section 127 emphasizes that past benefits can indeed constitute valid consideration. In a case involving the Oudh High Court in *SBI v. Premco Saw Mills*⁶, it was held that when a lessee agrees to pay a debt in installments and the surety agrees to discharge this liability at a later date, it qualifies as valid past consideration because it functions as a past benefit to the debtor.

The courts interpret the term "anything done" broadly enough to encompass the interests of the creditor, even if the benefit was provided before the suretyship arrangement was formed. The Karnataka HC in the case of *Jayakunvar Manilal Shah v Syndicate Bank*⁷ went on to say that the benefit to the principal debtor and execution of the surety bond need not be contemporaneous. Analysis of Section 2(d) of the ICA was held such that past consideration is valid and that we need not follow the English law which says that it needs to be contemporaneous⁸.

⁵ Chakhan Lal v. Kanhaiya Lal, AIR 1929 All 72.

⁶ SBI v Premco Saw Mills, AIR 1940 Oudh 346

⁷ Jayakunvar Manilal Shah v Syndicate Bank, 1991 SCC OnLine Kar 467

⁸ Devukutty Amma v Madhusudanan Nair, (1955) 2 KLT 118.

There has however been judgment restricting the acceptance of past consideration and being held invalid⁹. There have been judgments such as *Union of India v. Avinash P. Bhonsle*¹⁰ where it was argued that ‘anything done’ cannot be construed to mean anything done in the past as this connotes an ‘unnatural’ meaning to the same. In *Ram Narain v Lt. Col. Hari Singh and Anr.*, it was held that Past consideration cannot be held that past consideration must be contemporaneous and the same is substantiated by the third illustration. The line of reasoning used is that Section 2(d) of ICA talks about consideration moving at the desire of the promisor and if it has been done in the past, then it isn’t moving at the desire of the promisor as required while giving a guarantee. The Judge while answering that question on the validity of past debt held “From this illustration, I feel fortified in my conclusion that anything done or any promise made for the benefit of the principal debtor must be contemporaneous to the surety’s contract of guarantee to constitute consideration therefore. A contract of guarantee executed afterward without any consideration is void. Illustration (c) to Section 127 completely negatives a consideration which the Oudh court has chosen to give to Section 127 of the Indian Contract Act.”

This has been criticized in cases where it has been said that illustrations cannot have presiding or binding legality concerning the original section as they are merely meant to show the intention of the framers, and while facilitating the meaning of the section, they cannot exhaust it of its usual interpretation as held in *Aniruddha Mitra v. The Administrator General of Bengal and Ors*¹¹. The courts recognize that illustration isn’t capable of exhausting the context of a section as it cannot curtail or expand its ambit. The language of Section 127 is wide enough to construe anything that was done or a promise made before giving the guarantee and cannot restrict application to anything done contemporaneously.

Therefore, conflicting views exist on the question of past debt. Some believe in the wording of the main section, while others rely on the illustration. Some others believe that it's against legal principles to give precedence to an illustration over the main section. With a plethora of diverging opinions, we should realize that a contract of guarantee is a contract first, and thus, standard principles of consideration apply nonetheless. For the past debt to be valid in a contract, the creditor should have suffered a detriment at the instance of surety. There are two aspects to keep in mind, that is the necessity of suffering detriment by the creditor and such detriment being at the instance of the surety.

⁹ *Nanak Ram v Mahin Lal and Pestonji Meekji Mody v. Meherbai* (1875) ILR 1 All 487

¹⁰ *Union of India v Avinash P Bhonsle*, 1991 Mah LJ 1004.

¹¹ *Aniruddha Mitra v. The Administrator General of Bengal and Ors.* (1949) 51 BOMLR 971.

Creditor enduring a loss:

For the first element, a good consideration would be one where some profit or benefit accrues to the party for some detriment or loss suffered. This means that consideration should be one which either benefits the receiving it or a detriment to the person giving it. Even if the surety derives no benefit, the creditor must suffer a detriment. In *Paulo Verghese v. Ittipe Abraham*¹², the Court held that “there is no suggestion of any benefit which the creditor was prepared to confer on the principal debtor at the request of the surety. The debt was already contracted and subsequently, the alleged surety is stated to have come forward and said that he would be responsible for the discharge of the debt. The creditor did not suffer any detriment at the instance of the surety. This is an obvious instance of a promise not supported by consideration and for that reason cannot be enforced in a Court of Law.”

Detriment incurred at the behest of the surety:

The second element requires the detriment to be at the request of the surety. In general, consideration to support a promise of guarantee is seen in an act done before it is made, if the act is done at the surety's request such that parties understand that the act is meant to be compensation is a way that conferment of a benefit would be legally applicable had it been a promise in past¹³. However, in many conceivable situations, once we understand the specific circumstances behind a particular recommendation or request, distinguishing between the two is usually not a challenging task. A request or desire typically conveys a greater sense of urgency and personal concern compared to a mere recommendation. In *Muthukaruppa Mudali. vs Kathappudayan*¹⁴ the court held that the contrast between a request and recommendation is important to be drawn as just because a person recommends certain advances, this isn't sufficient consideration for expecting a subsequent promise to be made guaranteeing their payment. It was also argued that the advances made to another person on recommendation of the respondent were sufficient past consideration. The court in this case referred *Juggot Choudhry v. Nistarinee Dasse*¹⁵ where one of the obiter dicta said that mere recommendation by one party to another to lend money to a third party doesn't render the first party liable to repay the loan.

¹² Paulo Verghese v, Ittipe Abraham AIR 1952 Tr & Coch 202.

¹³ Pau On v Lau Liu Long

¹⁴ Muthukaruppa Mudali and Ors. vs Pi. Mu. Kathappudayan and Ors. (1914) 27 MLJ 249

¹⁵ Juggot Indur Narain Roy Choudhry v. Nistarinee Dasse (1876) 24 W.R. (Civil Rulings) 445.

Hence, a guarantee for a previous debt can remain legally valid as long as the past debt was incurred at the request of the guarantor and proved to be detrimental to the creditor. If the consideration had already been transferred without the involvement of the guarantor, the principal debtor would have already received the advantage, and the creditor would have voluntarily suffered the loss before the guarantor became involved. When a guarantor enters into a guarantee contract, their role is not to benefit the primary debtor but to ensure payment on behalf of the creditor. Consequently, rather than the primary debtor benefiting, it is the creditor who gains an advantage from the suretyship contract, which is contrary to the expected outcome.

CONCLUSION:

Many international jurisdictions such as that of Hong Kong, Singapore, and the UK, circumvent the traditional interpretation of the law stating that past consideration is invalid mainly due to a lack of commercial sense. For instance, in Hong Kong, the strict literal interpretation of the law would lead to the conclusion that past consideration is not valid. However, judicial decisions in Hong Kong have viewed the act of giving a guarantee as part of a single transaction along with the underlying contract. In many cases, there is an implied term to secure a guarantee when forming the contract. Therefore, if the surety becomes involved after the contract is formed, it cannot be argued that there is no consideration, as it is considered part of one continuous transaction. The courts in Hong Kong have consistently suggested that to avoid this ambiguity and address the issue, parties should execute a guarantee contemporaneously with the underlying contract¹⁶.

Even though the Supreme Court hasn't decided on any case related to this issue, in a recent case in 2020 the Supreme Court did make a statement that "Under Indian Law, which is significantly different from English Law of Contract, past consideration or the consideration towards third person is statutorily held to be good consideration as defined in Section 2(d) and as mentioned in Section 127 of the Contract Act. However, this particular case¹⁷ was not related to past consideration and hence it is only obiter dicta and not binding". But Indian Courts allow for past consideration to create more flexibility and execution of contracts created with the intention of suretyship or guarantee. This interpretation has been upheld by numerous High Courts and, more

¹⁶ DEACONS, <https://www.deacons.com/news-and-insights/publications/have-you-provided-good-consideration-for-your-guarantee.html>, (last visited May 22, 2021).

¹⁷ Anuj Jain v Axis Bank Limited & Ors, MANU/SC/0228/2020

recently, by the Supreme Court. Although the matter is still subject to debate, the Supreme Court's statement affirming the validity of past consideration has provided a clear direction for the country's courts to follow. This direction is expected to be advantageous for commercial activities in India.

