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Sticky Situation Guaranteed Forbearance and Limitations

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ABSTRACT

The Indian Contract Act, 1872 encompasses the concept of contract of guarantee and in these provisions lies section 134 and 137 as well which discusses the possibility of the creditor to forbear enforcement of his right against a principal debtor after he defaults. This forbearance can be thought as consideration for the contract but the duration of this forbearance may be viewed with some uncertainty. This paper aims to deal with the same issue by analysing the interplay of the Indian Contract Act and the Limitations Act, 1963 while discussing the result of forbearance past the time period stipulated by the statute of limitations. This perspective has not been dealt with comprehensively and therefore by doing so, it can lead to an enhanced understanding of the concept of forbearance.

Keywords: *Indian Contract Act, Contract of Guarantee, Forbearance, Limitations Act.*

I. INTRODUCTION

A layman's understanding of the word guarantee can be restricted to perhaps a formal assurance or even a security; however in the legal connotation, there is a precise definition which arises out of section 126 of the Indian Contract Act, 1872 (hereafter "the ICA"). 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 parties to a contract of guarantee are a Creditor, a Principal Debtor and a Surety. In this contract, the surety promises to incur the principal liability in case the Principal Debtor defaults.

Therefore, the surety can be made liable only after the original liability becomes recoverable by the Creditor only after which the Principal Debtor defaults. As per the provisions of the ICA, the discharge of this liability can be done in four ways. The first one being by the actual fulfillment of the debt - wherein the surety makes good the original principal debt and as a result arises an implied contract of indemnity in which the principal debtor must compensate the surety for the liability he incurred on his behalf. The second one being covered by section 133 of the ICA, wherein any change or variance made in the contract by the Creditor and

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Principal Debtor without the consent of the surety results in the surety's liability being extinguished. The third one being covered by section 134 of the ICA, wherein any act done by the Creditor which releases the Principal Debtor from his original liability also releases the surety of his liability. Lastly, covered by section 135 of the ICA, an act wherein the creditor makes "*a composition with, or promises to give time to, or not to sue the principal debtor*" results in the discharge of the surety's liability unless the surety gives his consent to it.

What's interesting, in the last method of discharge, the "*not to sue the principal debtor*" does not amount to forbearance to sue since forbearance deals with delaying the act of suing rather than not suing at all. Furthermore, section 137 of the act clarifies that mere forbearance by the Creditor does not discharge the surety. In addition to this, forbearance to sue can be comprehended as a consideration for a contract of guarantee as well due to the unique definition of consideration under a contract of guarantee as clarified by section 127 of the Act which resolves 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.*"

II. UNDERSTANDING THE CONCEPT OF FORBEARANCE

"Forbearance to sue" means that an individual has a certain right of action against the other party in the contract or any other person and on a promise by the said person, refrains from bringing the action. The relationship of parties agreeing to forbearance to sue was made clear in *Debi Radha Rani v Ram Dass*², wherein a wife who had a right of action against her husband for non-payment of maintenance allowance agreed to forbear in exchange of giving her a monthly allowance. Here the Patna High Court held that the act of forbearance is a valid consideration and therefore it was a valid contract as well.

However, we are taking a contract of guarantee into consideration and things are slightly different in such a contract simply because there are three parties involved - as mentioned earlier, the Creditor, the Principal Debtor and the Surety or Guarantor. More often than not, forbearance to sue in a contract of guarantee plays out in the following way; an individual defaults and therefore the creditor now has a valid claim against the individual, a third person requests forbearance on part of the creditor and assures or *guarantees* the creditor that if in case the principal debtor does not pay the debt, he or she will do so on behalf of the principal debtor.

As discussed earlier as well, this sort of arrangement where it was carried out for the benefit of the principal debtor is considered to be valid consideration under section 127. Although

² AIR 1941 Pat 282.

section 135 of the Indian Contract Act provides for the discharge of a surety in case the creditor gives time to the principal debtor, section 137 states that mere forbearance does not discharge the surety. In addition to this, the original debt to exist is extremely important as well because forbearance of a non-existing claim would not be forbearance at all, as held by Lord Blackburn in *Cook V. Wright*³. The same view was carried forth in *Manna Lai v Bank of Bengal* wherein the debtor pledged his house and shop as security for payment in case of dishonour of debt and the courts held that there was no real consideration.⁴

Although from the above discussion of forbearance in a contract of guarantee, one might think that the same is a clear concept as a whole however, this may not be the case. To aid the process of a better comprehension, we can consider a more intricate scenario. What happens to a contract of guarantee in which the consideration is forbearance and this forbearance is prolonged past the statute of limitations? Does the forbearance allow any suit arising from the contract to survive past the limitation period or the Statute comes into force irrespective of the same?

III. OBSERVATIONS FROM THE STATUTE OF LIMITATIONS

In the situation that we are taking into account, there are few main things to consider that will help us decide what happens in this scenario; the first one being the right of action that the creditor has as a result of the principal debtor defaulting, the second one being that in exchange of not acting on this right the third person assures payment in case the principal debtor defaults again, the third being that this right to bring a suit is subject to the provisions of the Limitations Act 1963 (hereafter “the Act”).

Under entry 15 of part II of the Schedule under the Act, the time period to bring a suit for enforcement of a contract of a similar nature⁵ is three years after the period of credit expires which means when the principal debtor defaults in our scenario; therefore, the creditor can forbear to act on this right for a total of three years as per the provision of the Act. However, one might argue that the time period might get paused due to this agreement to forbearance but this is clearly clarified by section 9 of the Act which reads “*Where once time has begun to run, no subsequent disability or inability to institute a suit or make an application stops it*”⁶. Therefore, a reading of the Schedule and Section 9 of the Act indicates that forbearance past the time period set by the Act results in the extinguishment of the right to bring a suit.

³ (1861) 1 B&S 559. See also *Krishna Chandra Dutta Roy V. Hemaja Sankar Nandi* [(1917)22 CWN 463]

⁴ ILR (1875-80) 1 All 309

⁵ The said entry covers a suit against a contract for the price of goods sold and delivered to be paid for after the expiry of a fixed period of credit.

⁶ Section 9, Limitations Act, 1963.

Furthermore, once the time period as per the Act has concluded, its provisions would prohibit any suit from being brought about for enforcement of the same. This would mean that the creditor is barred from suing the principal debtor and therefore in a way goes against the essential of a contract i.e if any law prohibits the objective of a contract, that contract is said to be void. Lastly, the said act of forbearance is done by the consent of the creditor and he agrees to do so as consideration for the contract of guarantee as per section 127 of the ICA. Therefore, if the act of forbearance is continued to the point where the Act bars any suit or recovery on behalf of the creditor, he must bear the consequence of the same since it is reasonably foreseeable to know that once the time period of the Act expires no recovery is possible.

IV. CONCLUSION

To conclude and encapsulate the contentions made in this paper, a forbearance to sue is a valid consideration in a contract of guarantee wherein the creditor agrees to delay enforcement of his right to action against the principal debt due to his default on the assurance that the surety would pay in case there is another default. Although section 137 of the ICA provides that mere forbearance does not discharge the surety from his liability, this forbearance cannot extend past the time period set by the Limitations Act, 1963 and its provisions under the Schedule and section 9 of the same.
