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Foresight: Law in Transition

BEYOND THE ALL-OR-NOTHING APPROACH: SUPREME COURT REDEFINES GUARANTOR LIABILITY

Can a guarantor be held either fully liable, or completely discharged, when a lender unilaterally alters the borrower's credit facility? Recently, the Supreme Court rejected the "all-or-nothing" approach and clarified that a guarantor's liability may be discharged only to the extent of the unauthorised variation.

The core issue concerned whether a guarantor's silence amount to consent? Answering in the negative, the Court observed that as per Section 133 of the Indian Contract Act, 1872 ("ICA"), any variance made, without the surety's consent, in the terms of the original contract between the principal debtor and the creditor discharges the surety as to transactions subsequent to the variance.

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It further clarified the distinct operation of Sections 133 and 139 of the ICA. While Section 133 of the ICA applies where the terms of the principal contract are varied without the surety's consent, Section 139 of the ICA applies only where two conditions are cumulatively satisfied: (i) the creditor's conduct is inconsistent with the surety's rights; and (ii) it materially impairs the surety's right of recourse against the principal debtor. The Court emphasised that the two provisions address different situations and cannot be applied interchangeably.

This decision strengthens protection to sureties against unilateral actions that increase a sureties’ exposure beyond what was originally agreed, while also placing a practical obligation on banks and financial institutions to communicate material changes to a borrower's credit facility. The ruling reinforces that silence cannot be treated as consent where the guarantor's risk is increased, and promotes greater transparency and certainty in guarantee enforcement.