

UNIT - 7 :- CONTRACT OF INDEMNITY AND GUARANTEE

→ contract of indemnity and guarantee

↳ specific types of contracts

[sec. 124 to sec. 147]

→ General principles of contracts are also applicable to such contracts which include:

a) offer and acceptance

b) intention to create legal obligation

c) consideration

d) competency to contract

e) free consent

f) lawful object

g) The agreement must not be expressly declared to be void.

h) The terms of the agreement must not be vague or uncertain.

i) The agreement must be capable of performance

j) legal formalities.

CONTRACT OF INDEMNITY

→ DEFINITION uls 124 of Indian Contract Act, 1872 -

"A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person."

→ MEANING -

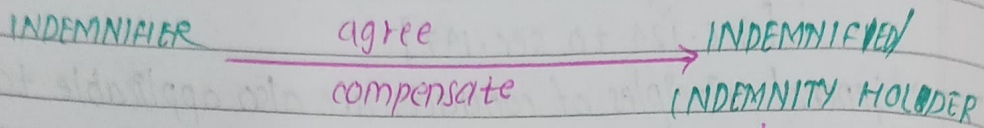
Indemnity / Indemnify means:

• Security against loss [or]

• To make good the loss [or]

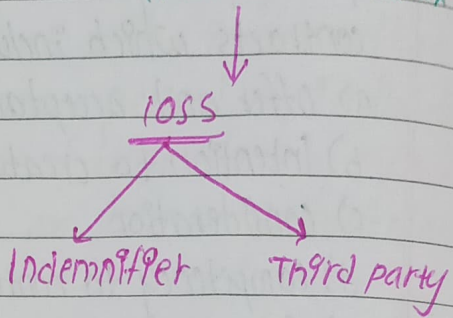
• To compensate the party who suffered some loss.

CONTRACT
(TWO PARTIES)

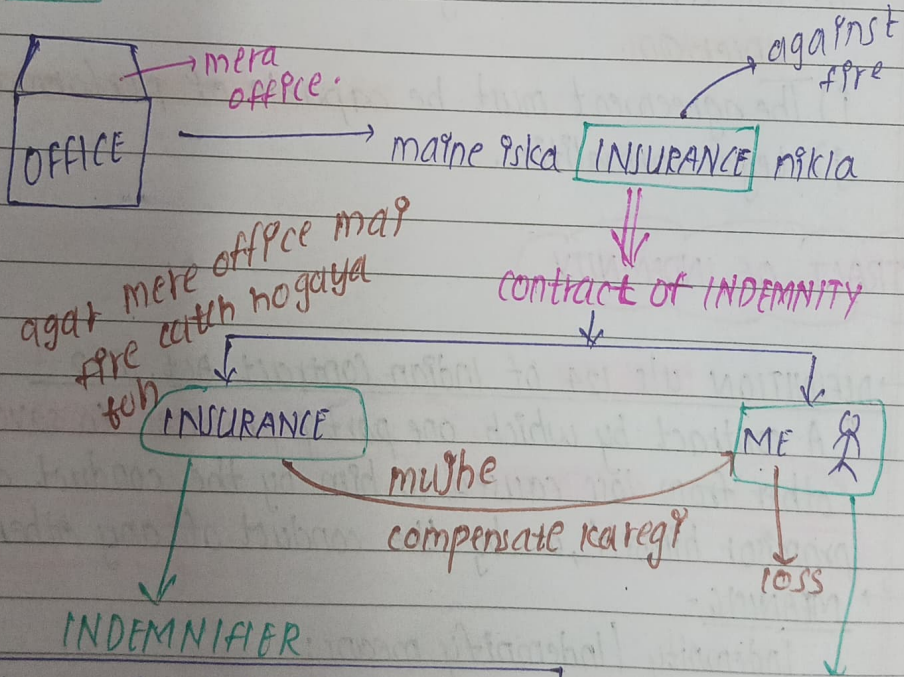


INDEMNIFIER → the one who promises to indemnify / save the other party from loss.

INDEMNIFIED → the one who is promised to be saved against the loss



EXAMPLE :-



Imp

Agar maine janbujke aag lagaya mere office mai taaki mujhe paisa mil sake toh insurance company hume compensate nhi karegi. sirf loss by

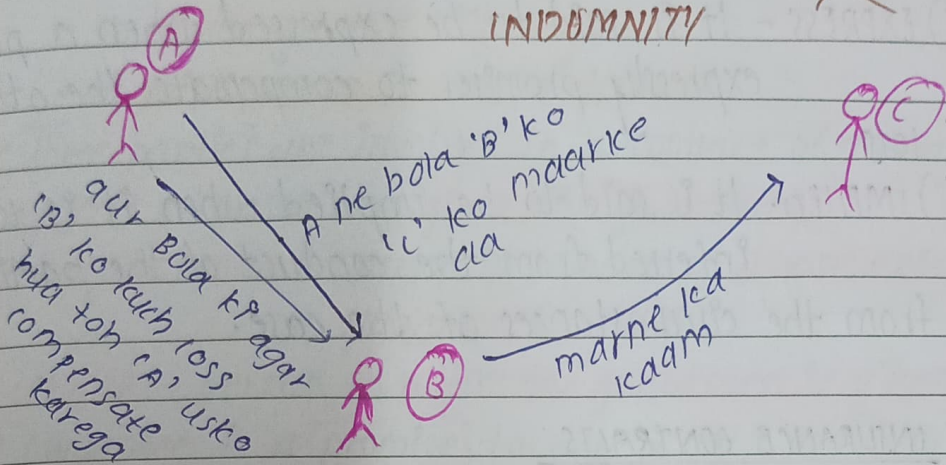
INSURANCE.COM. Third party

INDEMNIFIED / INDEMNITY HOLDER

→ agar kuch loss hua due to act of god like earthquake, flood, landslide, etc toh insurance company hume compensate nhi karegi.

EXAMPLE:-

CONTRACT OF INDEMNITY → ~~valid nhi hai~~



→ In case of GAJANAN MORESHWAR vs MORESHWAR MADAN (1942)

According to English law, INDEMNITY means promise to save another harmless from the loss. It covers every loss whether due to negligence of promisee or by natural calamity or by accident.

→ BASIC CONDITIONS-

- (1) under a contract of indemnity the "existence of loss" is essential.
- (2) Unless the promisee has suffered a loss he cannot liable on the contract of indemnity.
- (3) Such loss is caused by:
 - conduct of the promisor himself or
 - conduct of any other person.

(4) loss occasioned by:

- an accident not caused by any person or
- an act of god / natural event is not covered.

→ MODE OF CONTRACT OF INDEMNITY

- i) EXPRESS - It is said to be expressed when a person expressly promises to compensate the other from loss.
- ii) IMPLIED - It is said to be implied when it is to be inferred from the conduct of the parties or from the circumstances of the case.

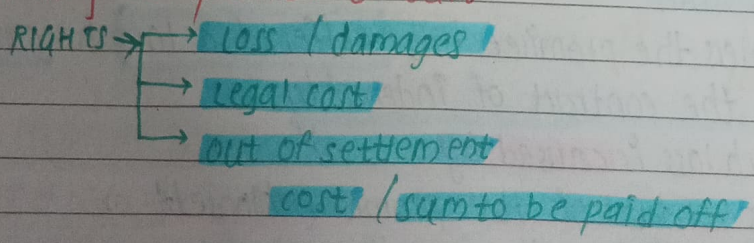
→ INSURANCE CONTRACTS

- a) Fire Insurance or Marine Insurance → Contract of Indemnity
- b) Life Insurance → Not a contract of Indemnity

→ RIGHT OF INDEMNITY - HOLDER [Section 125]

entitled to recover from the promisor / indemnifier:

- a) all damages which he may be compelled to pay in any suit.
- b) all costs which he may have been compelled to pay in bringing / defending the suit
- c) all sums which he may have paid under the terms of any compromise of suit.



CONTRACT OF GUARANTEE

→ "CONTRACT OF GUARANTEE", "SURETY", "PRINCIPAL DEBTOR", and "CREDITOR" [Section 126]

→ A contract of guarantee is a **contract**

- to **perform the promise** or
- to **discharge the liability**
- of **third person in case of default**.

→ Three parties are involved in a contract of guarantee:

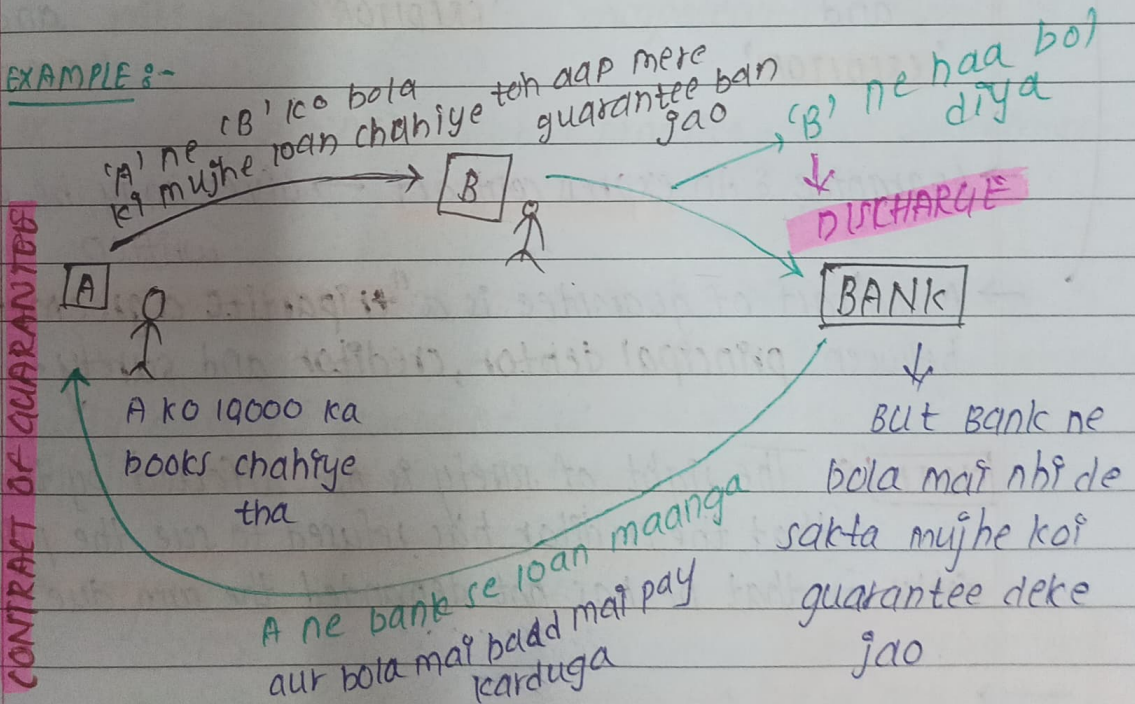
SURETY :- person who **gives the guarantee**.

PRINCIPAL DEBTOR :- person in respect of **whose default the guarantee is given**.

CREDITOR :- person to **whom the guarantee is given**.

→ Guarantee is a **promise to pay a debt owed by a third person in case the latter does not pay**.

EXAMPLE :-

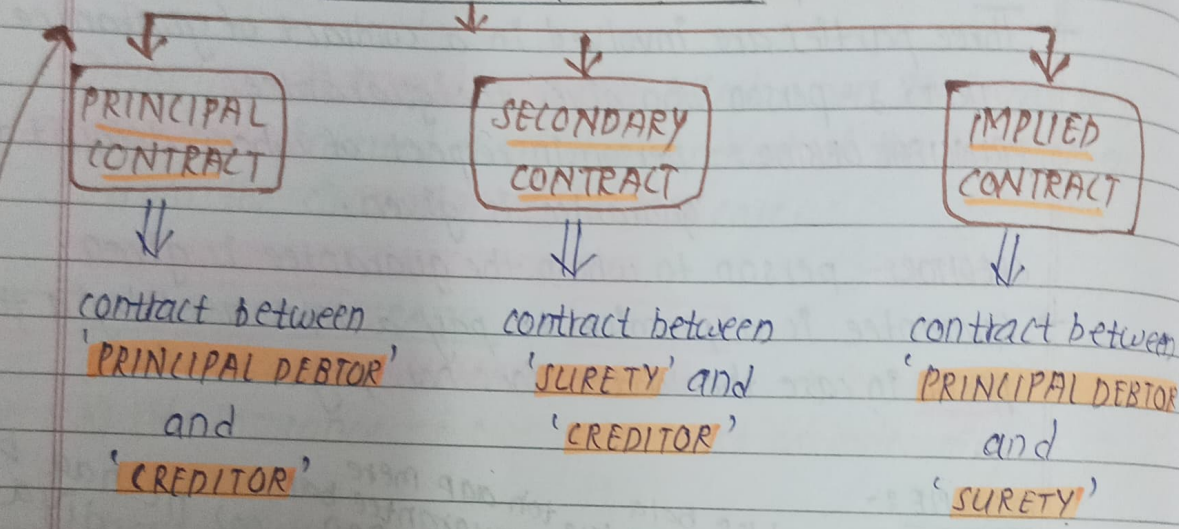


Incase, agar 'A' paisa nhi chuka paya toh 'B' as a guarantee usko discharge karke bank ko paisa dega.

3 parties to the contract

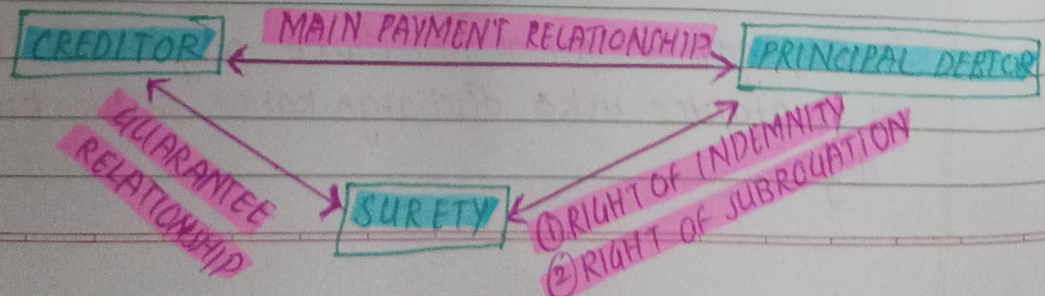
- A → PRINCIPAL DEBTOR
- B → SURETY (with party's guarantee of pay in case of any default)
- BANK → CREDITOR

3 contracts in guarantee



- Guarantee: An express contract → given may be oral or written
- A contract of guarantee is a "tripartite agreement" between principal debtor, creditor and surety.

NOTE : The right of surety is not affected by the fact that the creditor has refused to sue the principal debtor or that he has not demanded the sum due from him.



→ ESSENTIALS FEATURES OF A GUARANTEE 8

(1) **PRINCIPAL DEBT** : existence of recoverable debt is (purpose) necessary.

(2) **CONSIDERATION** : should be supported by some consideration.

- There is no need for a direct consideration between the surety and the creditor.

- Consideration received by the principal debtor is sufficient consideration to surety for giving the guarantee.

- Principal debtor incompetent to contract : Guarantee is valid.

- Surety ~~is~~ incompetent to contract : Guarantee is void (surety must be competent to contract)

(3) **EXISTENCE OF A LIABILITY** or a promise whose performance is guaranteed.

(4) **NO MUREPRESENTATION OR CONCEALMENT** : By the creditor in obtaining guarantee.

Surety must be aware of all material facts w.r.t liability / promise else it shall be invalid.

→ Any promise made (+)

Anything done (+)

For the benefit of principal debtor

CONSIDERATION FOR GUARANTEE

(5) Guarantee may be **EITHER ORAL OR WRITTEN**

(6) **JOINING OF THE OTHER CO-SURETIES (SECTION 144)** where a person gives a guarantee upon the condition that another surety must join along with him, and no such person joins as surety then such guarantee is **not valid**.

TYPES OF GUARANTEES

SPECIFIC GUARANTEE

- jab kisi **single debt** gaa **specific transaction** ki ap **guarantee** dete ho wah "specific guarantee" hota hai.
- Surety ki **liability end** ho jati hai jab guaranteed **debt discharge** ho jata hai.

CONTINUING GUARANTEE (SECTION 129)

- jab **guarantee** ko **specific** nhi balki **numbers of transactions** ki dete hai toh wah "continuing guarantee" hota hai.
- surety ki **liability** tab tak **continue** rahegi jab tak woh **revoked** na kare **apne guarantee** ko.

DISTINCTION BETWEEN CONTRACT OF INDEMNITY AND CONTRACT OF GUARANTEE

POINT OF DISTINCTION	CONTRACT OF INDEMNITY	CONTRACT OF GUARANTEE
PARTIES TO THE CONTRACT	There are two parties namely indemnifier (promisor) & indemnified (promisee).	There are three parties - creditor , principal debtor and surety

NATURE OF LIABILITY

Liability of the indemnifier is primary and unconditional.

Liability of the surety is secondary and conditional as the primary liability is of principal debtor.

TIME OF LIABILITY

Liability of the indemnifier arises only on the happening of an uncertain event.

Liability arises only on the non-performance of an existing promise or non-payment of an existing debt.

TIME TO ACT

Indemnifier need not act at the request of indemnity holder.

Surety acts at the request of principal debtor.

RIGHT TO SUE THIRD PARTY

Indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour.

Surety can proceed against principal debtor in his own right because he gets all the right of a creditor after discharging the debt.

PURPOSE

Reimbursement of loss.

For the security of creditor.

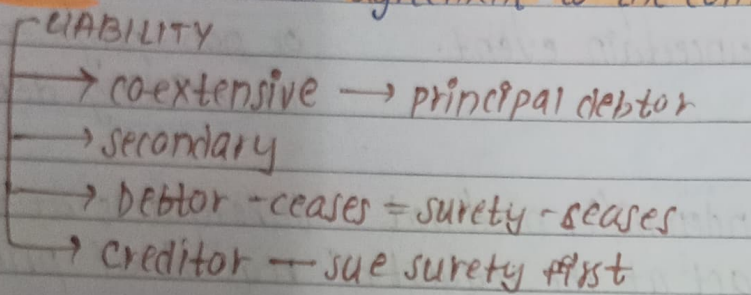
COMPETENCY TO CONTRACT

All parties must be competent to contract.

Where a minor is a principal debtor, the contract is still valid.

→ NATURE AND EXTENT OF SURETY'S LIABILITY [SECTION - 128]

- (1) liability of surety is co-extensive with that of principal debtor unless it is otherwise provided by contract (Section 128)
- (2) liability of surety is of secondary nature, he is only liable on default of principal debtor
- (3) where a debtor cannot be held liable on account of any defect in document, the liability of the surety also ceases.
- (4) creditor may choose to proceed against a surety first, unless there is an agreement to the contrary.



→ DISCHARGE OF A SURETY

- (1) A surety is said to be discharged when his liability as surety comes to an end.
- (2) Various modes of discharge of surety are :-

BY REVOCATION OF THE CONTRACT OF GUARANTEE	BY CONDUCT OF THE CREDITOR	BY THE INVALIDATION OF THE CONTRACT OF GUARANTEE
a] Revocation of continuing guarantee by notPre. [Section 130]	a] By variance in terms of contracts [Section 133]	a] Guarantee obtained by misrepresentation invalid [Section 142]
b] Revocation of continuing guarantee by surety's death. [Section 131]	EXCEPTION - variation which is not substantial or material or which is beneficial to surety will not discharge him of his liability.	b] Guarantee obtained by concealment invalid. [Section 143]

c] By Novation
[section 62]

b] By release or discharge
of principal debtor

[section 134]

c] Discharge of surety
when creditor comp-
ounds with, gives time
to, or agree not to
sue principal debtor

[section 135]

(i) composition

(ii) promise to give time

(iii) promise not to
sue.

EXCEPTION :- (i) surety not
discharge when agree-
ment made with third
person to give time to
principal debtor

[section 136]

(ii) creditor's forbear-
ance to sue does
not discharge surety

[section 137]

d] Discharge of surety by
creditor's act or
omission impairing
surety's eventual
remedy [section 139]

c] Guarantee on
contract that
creditor shall
not act on it

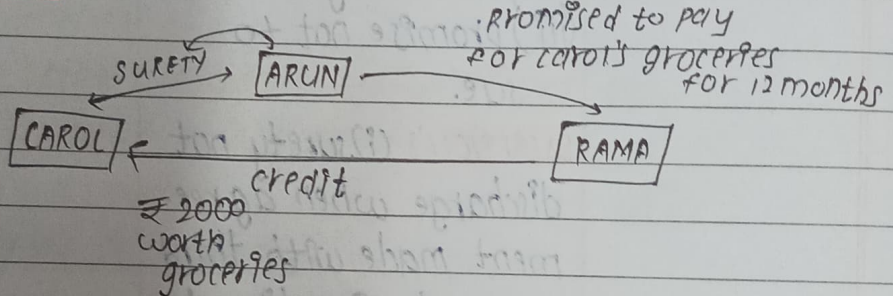
until co-surety
joins [section 144]

* BY REVOCATION OF THE CONTRACT OF GUARANTEE

a) Revocation of continuing guarantee by notice [section 130]:

- continuing guarantee → at anytime be revoked by the surety as to future transactions by notice to the creditors.
- Once revoked → surety is not further liable for any future transactions.
- specific guarantee can be revoked only if liability to principal debtor has not accrued.

EXAMPLE :-



CAROL buys goods worth ₹2000 from Rama, after 3 months Arun revoked the guarantee, Carol further purchases groceries worth ₹1000

- ↳ Arun is only liable to pay ₹2000
- ↳ If Carol fails to pay ₹1000 then Arun is not liable to pay for that as he already revoked the guarantee after 3 months.

b) Revocation of continuing guarantee by surety's death [section 131]:

→ death of surety operator as a revocation of a continuing guarantee as to the future transactions taking place

after the death of surety.

→ the surety's estate remains liable for past transactions which have already taken place before the death of the surety.

c) By Novation [section 82]:

→ surety under original contract is discharged if a fresh contract is entered

→ between either the same parties or the other parties
→ consideration - the mutual discharge of the old contract.

* BY CONDUCT OF THE CREDITOR

a) By variance in terms of contract [section 133]:

→ any variance in the terms of contract between the surety in respect of all transactions taking place principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

EXCEPTION

→ "Variation which is not substantial or material or which is beneficial to the surety will not discharge him of his liability."

b) By release or discharge of principal debtor [section 134]:

- surety is discharged if the creditor -
- (i) enters into a fresh/new contract with principal debtor, by which the principal debtor is released.
 - (ii) does any act or omission the legal consequences of which is discharge of principal debtor.

c) Discharge of surety when creditor compounds with, gives time to or agrees not to sue, principal debtor [section 135]:

→ a contract between the creditor and the principal debtor, discharges the surety, unless the surety assents to such contract:

(i) COMPOSITION - If the creditor makes a composition with principal debtor, without consulting the surety, the latter is discharged.

composition inevitably involves variation of the original contract and therefore, the surety is discharged.

(ii) PROMISE TO GIVE TIME - When the time for payment of guaranteed debt comes, the surety has the right to require the principal debtor to pay off the debt.

(iii) PROMISE NOT TO SUE - If the creditor under an agreement with the principal debtor promises not to sue him, the surety is discharged.

creditor's duty towards surety is to allow due care

cases where surety is not discharged -

(1) Surety not discharged when agreement made with third person to give time to principal debtor [Section 136] :-
 where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged.

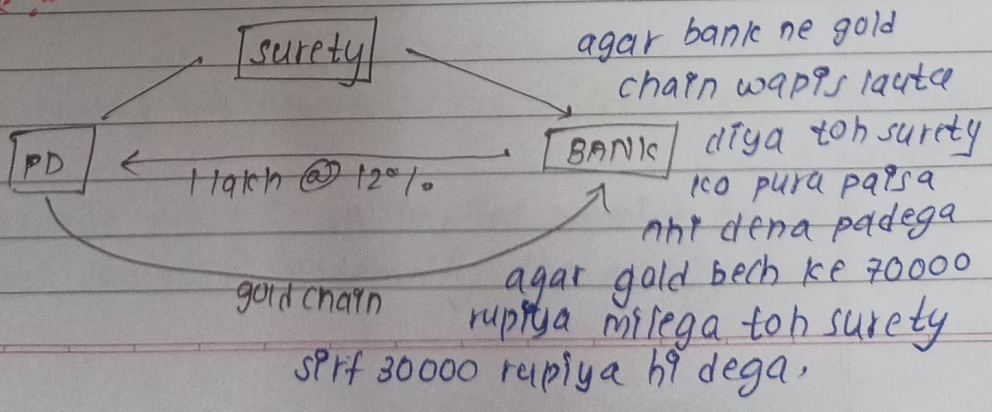
(2) Creditor's forbearance to sue does not discharge surety [Section 137] :-

Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy, against him does not in the absence of any provision in the guarantee to the contrary, discharge the surety.

d] Discharge of surety by creditor's act or omission impairing surety's eventual remedy [Section 139] :-

If creditor does any act which is inconsistent with the rights of the surety, or omits to do any act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.

Example :-



* BY INVALIDATION OF THE CONTRACT OF GUARANTEE

a) Guarantee obtained by misrepresentation invalid [Section 142] :-

Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.

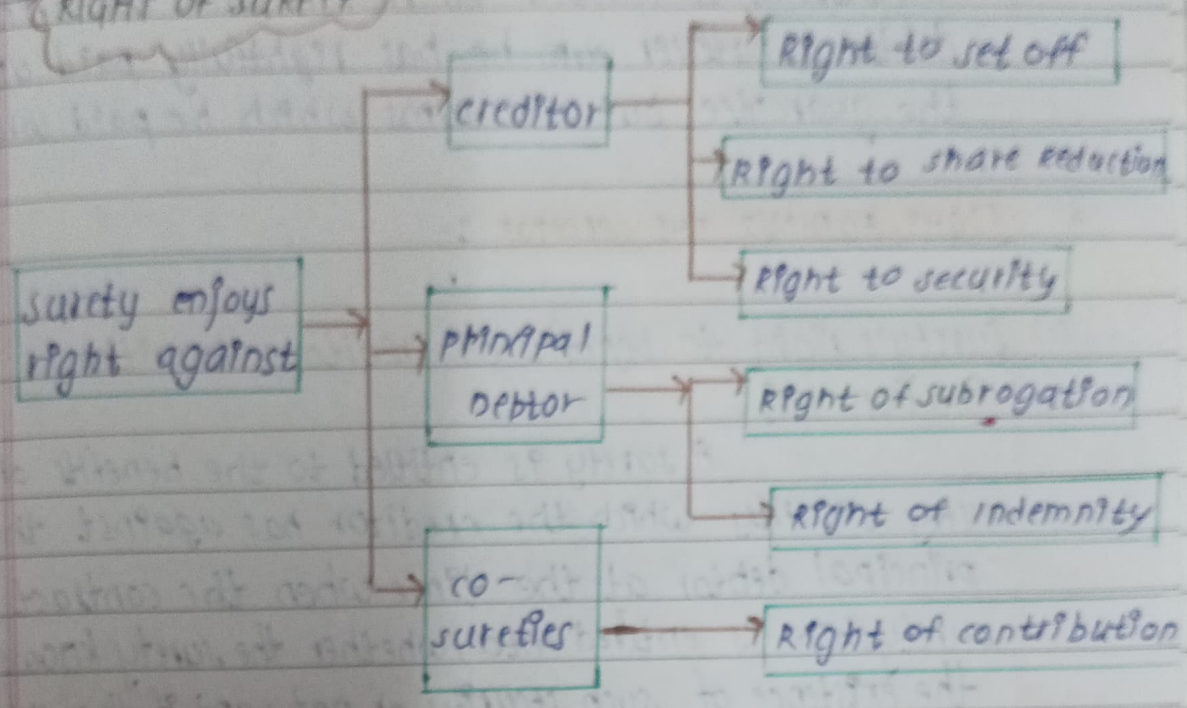
b) Guarantee obtained by concealment invalid [Section 143] :-

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

c) Guarantee on contract that creditor shall not act it until co-surety joins [Section 144] :-

where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.

RIGHT OF SURETY



* RIGHT AGAINST PRINCIPAL DEBTOR :-

(1) RIGHT OF SUBROGATION - [Section 140] :- where, a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor.
→ This right is known as subrogation.
→ It means that on payment of the guaranteed debt, or the performance of the guaranteed duty, the surety steps into the shoes of a creditor.

(2) IMPLIED PROMISE TO INDEMNIFY SURETY [Section 145] :- In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety.

→ The surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee but not sums which he paid wrongfully.

* RIGHT AGAINST THE CREDITOR :-

(1) Surety's right to benefit of creditor's securities :-
[Section 141] :-

A surety is entitled to the benefits of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and if the creditor loses, or without the consent of the surety, parts with such ~~necessary~~ security, the surety is discharged to the extent of the value of security.

(2) Right to set off :-

If the creditor sues the surety, for payment of principal debtor's liability, the surety may have the benefit of the set off, if any that the principal debtor had against the creditor.

(3) Right to share reduction :-

The surety has right to claim proportionate reduction in his liability if the principal debtor becomes insolvent.

* RIGHT AGAINST THE CO-SURETIES :

"when the same debt or duty is guaranteed by two or more persons, such persons are called co-sureties."

a) co-sureties liable to contribute equally [section 146] :

→ equality of burden is the basis of co-suretyship.

→ co-sureties in the absence of any contract to the contrary are liable between themselves to pay each an equal share of whole debt [or] of that part of it which remains unpaid by the principal debtor.

b) Liability of co-sureties bound in different sums [section 147] :

→ principle of equal contribution is subject to the maximum limit fixed by a surety to his liability.

→ co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

SUMMARY

contract of indemnity

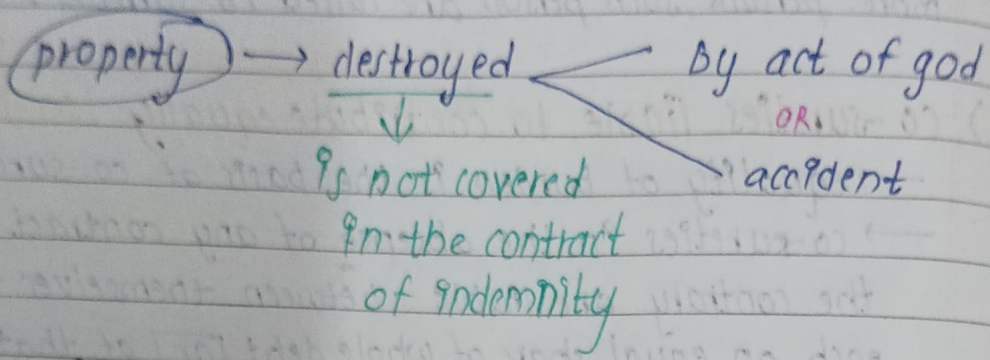
It's a contract in which indemnifier agrees to compensate the indemnitee for loss caused to him

either by
conduct of
indemnifier

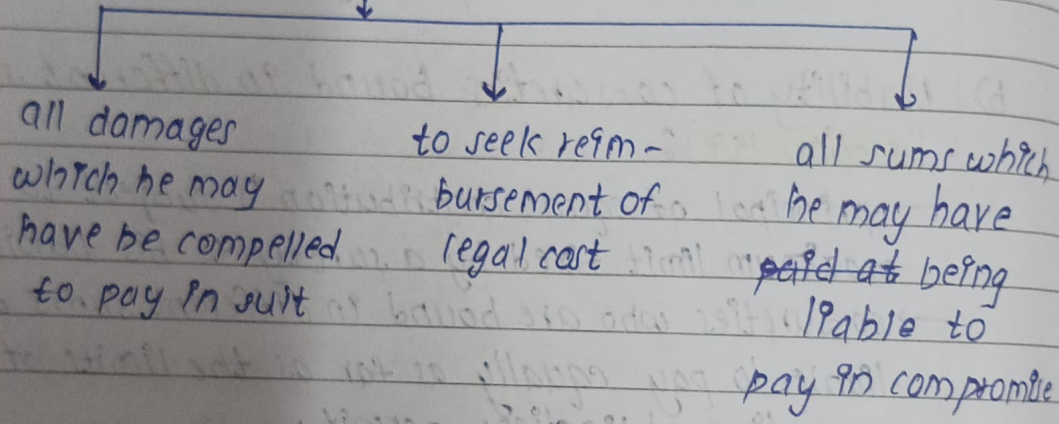
OR

or by
third party

- ex: - fire insurance / marine insurance
- life insurance → contract of indemnity [X]



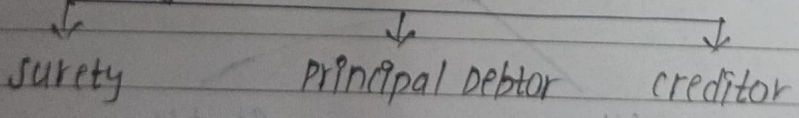
→ Rights of Indemnify Holder



contract of guarantee

→ It's a contract to perform promise or discharge liability in case of default.

→ 3 parties



→ 3 contract

