Unit-7: Contract of Indemnity & Guarantee

① Contract of Idemnity

Section-124:

The Contract of Idemnity is 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

* To indemnify means to compensate or make good the loss.

* Existence of loss is essential

* Covers only the loss caused by the conduct of the promisor himself or any other person.

* Must fulfill all the essentials of a valid contract

* A contract of fire or marine insurance is always a contract of idemnity. But, Contract of life insurance is not a contract of idemnity.

* There are two parties in a contract of idemnity

i) **Indemnifier** :- Promises to save the party from the loss.

(ii) **Indemnified** :- Promised to be saved against the loss

Eg A and B claims certain goods from a railway company as rival owners. A takes delivery of the goods by agreeing to compensate the railway company against the loss in case B turns out to be the true owner. This is a contract of indemnity.

(1.2) Rights of Indemnity holder :-

Section - 125 :

The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor / Indemnifier -

① All damages which he may be compelled to pay in any suit.

② All costs which he may be compelled to pay in bringing / defending the suit

③ All sums which he may have paid under the terms of any compromise of suit.

(1.3) Commencement of the Liability of the Indemnif

✱ The liability of an indemnifier commences as soon as the liability becomes absolute and certain.

✱ The object of indemnity is to save from loss and not merely to compensate the loss.

7.2 Contract of Guarantee

Guarantee :- A contract of guarantee is a contract to perform the promise made or discharge the liability, of a third person in case of his default.

Parties

| Principal debtor | Creditor | Guaranter/Surety |
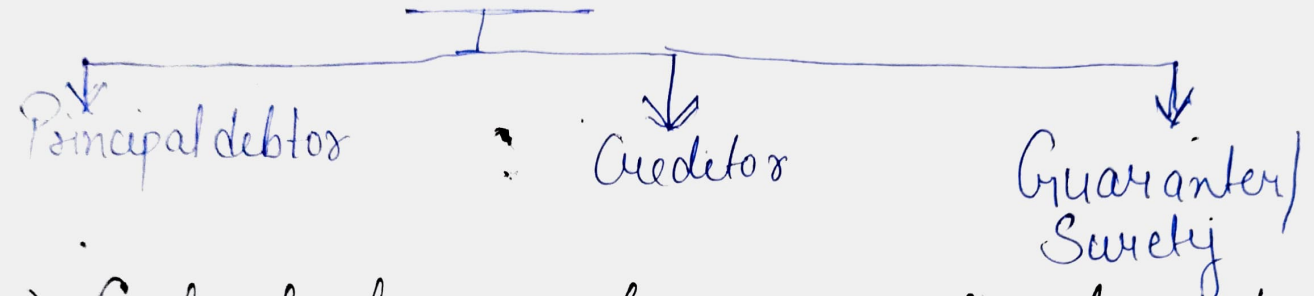
→ Contract of guarantee is a combination of 3 different contract.
  1. Creditor & Debtor
  2. Debtor & Surety
  3. Surety & Creditor

Essential Features of a Guarantee

1) **Purpose :-** The purpose of a guarantee being to secure the payment of a debt. If there is no principal debt, there can be no valid guarantee.

2) **Consideration :-** A guarantee without consideration is void, but there is no need for a direct consideration between the surety and the creditor.

3) **Existence of Liability :-** There must be an existing

④ **No misrepresentation or Concealment :-** Any guarantee (Section 142 & 143) which has been obtained by the means of misrepresentation is invalid (143) or, Any guarantee which the creditor has been obtained by means of keeping silence is invalid (Sec 143)

⑤ **Writing not necessary :-** Section 126 expressly declares that a guarantee may be either oral or written.

⑥ **Joining of the other co-securities :-** Where a person gives a guarantee upon a contract that the creditor shall not act upon it unit another person has joined in it as co-surety, the guarantee is invalid if that other person does not join.

Types of Guarantee

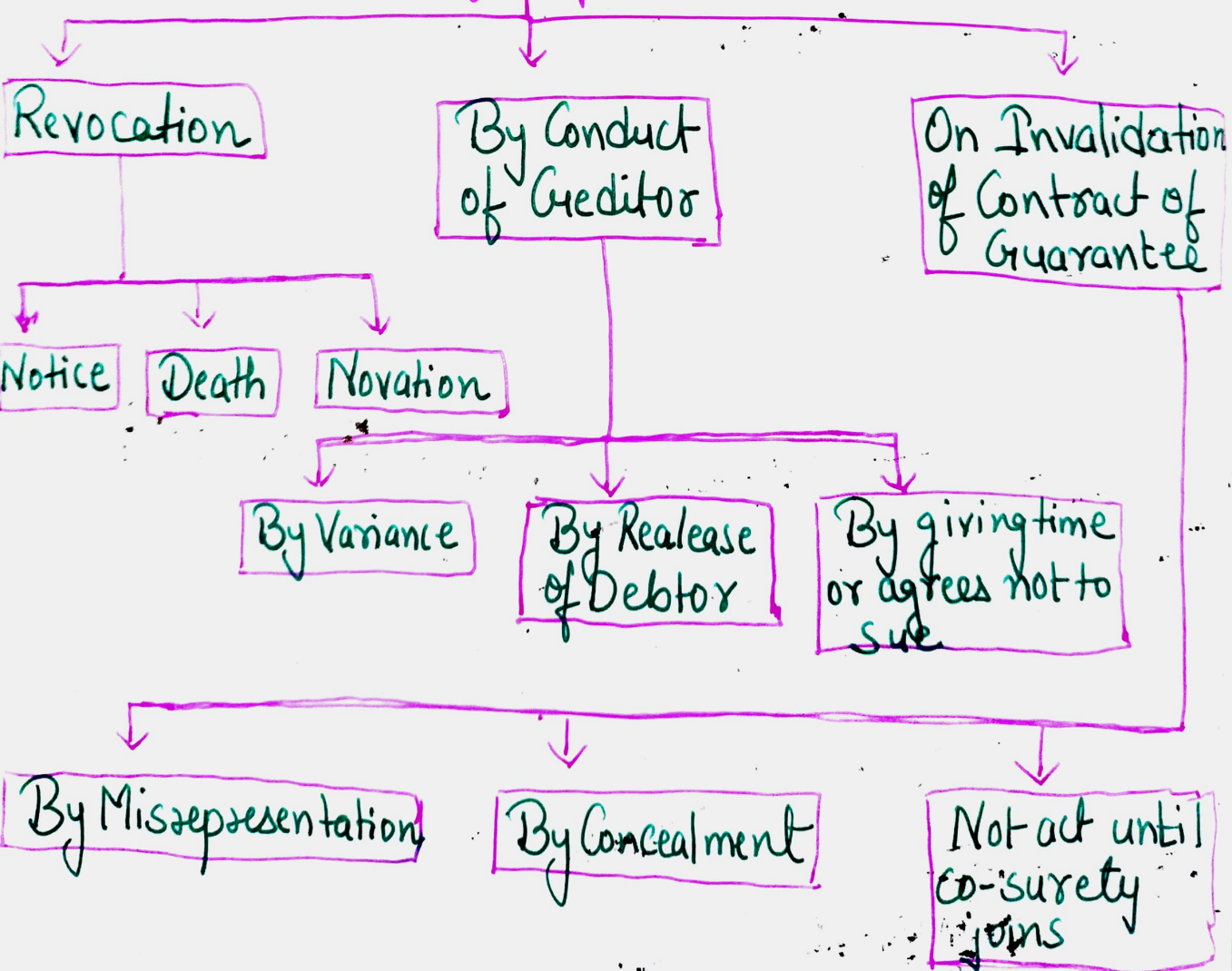| Specific guarantee	Continuing guarantee
Guarantee given only for single transaction	Guarantee given for a series of transaction
Specific guarantee cannot be revoked if the transaction has taken place.	Continuing guarantee can be revoked but only for future transaction for the past transaction the surety continues to remains liable.
Eg. X as a guarantee promised to repay the loan to Y in case of default by Mr. A (i.e a single loan)	Eg. House of Rent

Nature and Extent of Surety's Liability (Sec-128)

① The liability of the surety is co-extensive with that of principal debtor.

② Liability of Surety is of Secondary nature as he is liable only on default of debtor.

③ Where a debtor cannot be held liable on account of any defect then, liability of the surety also ceases.

④ A creditor may choose to proceed against a surety first, unless there is an agreement to the contrary.

① Discharge of a Surety

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                    Discharge of a Surety
        ┌──────────────────┬──────────────────────────┐
        ↓                  ↓                          ↓
  ┌──────────┐      ┌────────────┐          ┌──────────────┐
  │Revocation│      │ By Conduct │          │On Invalidation│
  └──────────┘      │ of Creditor│          │of Contract of│
        │           └────────────┘          │  Guarantee   │
   ┌────┼────┐             │                 └──────────────┘
   ↓    ↓    ↓             │                        │
┌──────┐┌─────┐┌─────────┐ │                        │
│Notice││Death││ Novation│ │                        │
└──────┘└─────┘└─────────┘ │                        │
              ┌────────────┼────────────────────────┤
              ↓            ↓                        ↓
        ┌──────────┐┌────────────┐          ┌──────────────┐
        │By Variance││ By Realease│          │By giving time│
        └──────────┘│ of Debtor  │          │or agrees not to│
                    └────────────┘          │    sue       │
                                            └──────────────┘
   ┌──────────────────────┬────────────────────────┐
   ↓                      ↓                        ↓
┌──────────────────┐┌───────────────┐    ┌──────────────┐
│By Misrepresentation││By Concealment│    │Not act until │
└──────────────────┘└───────────────┘    │co-surety     │
                                         │joins         │
                                         └──────────────┘
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By Revocation

ⓐ Revocation of continuing guarantee by Notice (Section 130

The continuing guarantee may any time be revoked for future transactions by giving notice to the creditor. Once, Surety is revoked, surety is not liable for future transactions.

ⓑ Revocation of Continuing guarantee by Surety's death (Section-131) :— Death of Surety operates as a revocation of a continuing guarantee for future transaction. However; Surety's estate remains liable for past transaction.

ⓒ By Novation (Section 62) :— The Surety under original contract is discharged if a fresh contract is entered into either same parties or different parties.

By Conduct of the Creditor

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ⓐ By variance in terms of Contract (Section 133):— When there is any variance in terms of contract between the debtor and creditor without Surety's consent, it would discharge the Surety in respect of all transaction taking place subsequent to such variance.
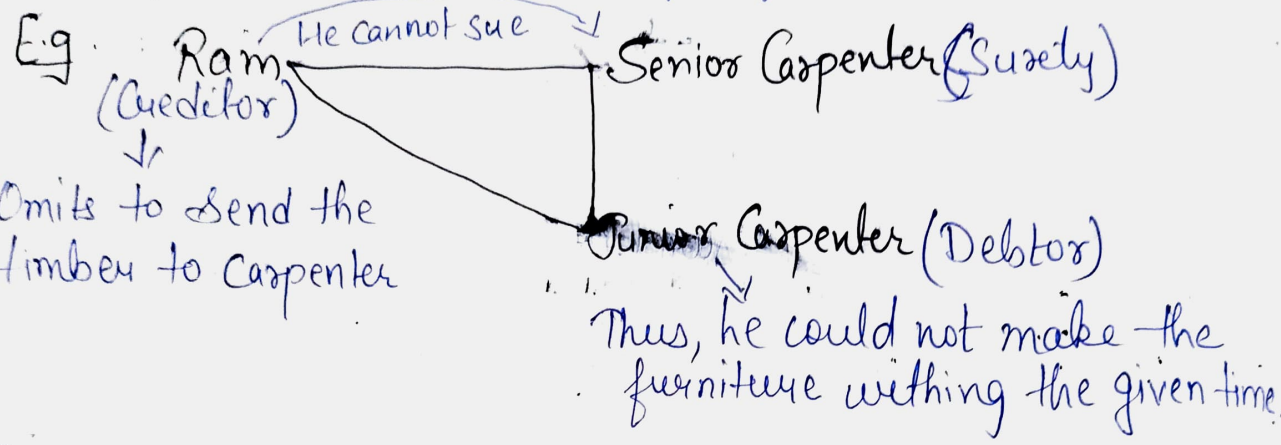
E.g. (Creditor) Bank ——————— Ram (Surety)

1/1/24 - 50K p·m
1/7/24 - 30K p·m ————— Shyam (Debtor).
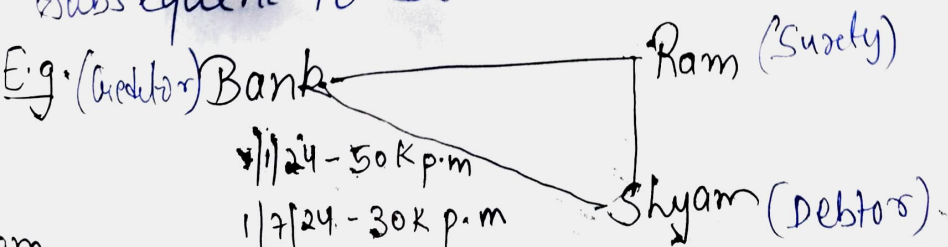
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Surety is discharged as there is variance without surety's consent

(b) By Release or discharge of principal debtor [Sec-1?

The Surety is discharged if the creditor :

(i) Enters into a fresh/new contract with debtor.

(ii) Does any act or ommission, the legal consequence of which is the discharge of the debtor.

Eg : Ram (Creditor) —He cannot sue→ Senior Carpenter (Surety)

Omits to send the timber to Carpenter

Junior Carpenter (Debtor)

Thus, he could not make the furniture withing the given time.

(C) Discharge of Surety when Creditor compounds with, gives times to, or agrees not to sue, principal debtor (Section 135) :- Discharges the Surety, unless the surety assents to such contract

(i) Composition : If the creditor makes a composition with the principal debtor, without consenlting the Surety, the latter is discharged.

(ii) Promise to give time :- Creditor has given more time to the debtor for payment of debt without surety consent here, the Surety will be discharged.

(iii) Promise not to sue : If the creditor under an agreement with the principal debtor promises not to sue him, the surety is discharge

By the Invalidation of the Contract of Guarantee

(a) Guarantee obtained by misrepresentation (Sec-142)

Any guarantee which has been obtained by means of misrepresentation made by the creditor, is invalid.

(b) Guarantee obtained by Concealment (Sec-143)

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

(c) Guarantee on contract that creditor shall not act on it until co-surety joins (Sec-144)

Where a person gives a guarantee upon a contract that the creditor shall not act until another person has joined in it co-surety, the guarantee is invalid.

(C) Cases where surety not discharged

(a) When agreement made with third person to give time to principal debtor (Section-136) :

Surety will not be discharged if the extension of the time period is done by the creditor with a third party.

(b) 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 sure

Rights of a Surety

Creditor

Principal Debtor

Co-Sureties

Subrogation

The Surety steps into the Shoes of the Creditor. Thus, the Surety will now demand the money from the principal debtor.

To Indemnify

It is implied that the debtor will have to idemnify the Surety as the surety has paid the amount on behalf of the principal debtor.

Rights of Creditor Securities

The Surety is entitled to get the benefit of every security which the creditor had against the principal debtor.

Rights of Set-off

The surety can do set-off of any debt between the principal debtor and Creditor.
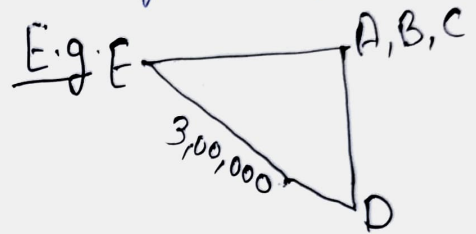
Share Reduction

If the debtor has been declared insolvent, the amount that is recoverable from him will be paid & then the same shall be proportionately reduced from the surety's liability.

Equal Contribution		Liability in different sums

Each surety is liable to contribute equally for the payment of the debt.

The principal of equal contribution or to the maximum limit fixed by surety.

E.g.

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E ──────────── A, B, C
 \            /
  \ 3,00,000 /
   \        /
        D
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A = 1 Lakh, B = 1 Lakh, C=