

The Indian Contract Act, 1872

Unit - 7 = Contracts of Indemnity & Guarantee

Contract of Indemnity.
(Sec. 124 - 125)

Contracts of Guarantee
(Sec. 126 - 127)

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(Sec. 128)

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(Sec. 129 - 132)

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⇒ 'Indemnify' meaning:-

▷ To make good the loss incurred by another person. or

▷ To compensate the party who has suffered some losses.

* "Contract of Indemnity" - Definition (Sec. 124) :-

⇒ 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.

Analysis of Definition

Sec. 124 covers the losses caused:

- (i) By the conduct of promisor himself or
- (ii) By the conduct of any other person.

Not covering loss:

- By the conduct of promisee,
- or accident,
- or act of God.

→ As per the English law, Indemnity means promise to save another harmless from the loss.

Here, it covers every loss whether due to negligence of promisee or by natural calamity or by accident.

* Parties to Contract :-

- Person who promises to compensate for

the loss is called the 'indemnifier'.

⇒ Person to whom this promise is made or whose loss is to be made good is known as the 'indemnity holder' or the 'indemnified'.

Example 1:- Mohan contracts to indemnify Sohan against the consequences of any loss due to fire. Here Mohan is 'Indemnifier' and Sohan is 'Indemnity Holder'.

* Modes of Contract of Indemnity:-

⇒ **Expressed**: When a person expressly promises to compensate the other from loss.

⇒ **Implied**: When the contract is to be inferred from the conduct of the parties or from the circumstances of the case. Case.

NOTE:- All the essentials of a valid contract must also be present in the contract of indemnity.

Example 2:- 'X' asks 'Y' to beat 'Z' and promises to indemnify 'Y' against the consequences. 'Y' beats 'Z' and is fined Rs. 1000. 'Y' cannot claim this amount from 'X' because the object of the agreement was unlawful.

* Reason for loss:-

⇒ The contract of indemnity must specify that indemnity holder shall be protected from the loss caused due to:-

→ Action of the promisor himself; or

→ Action of any other person; or

→ Any act, event or accident which is not in the control of the parties.

* Right of Indemnity Holder (sec. 125)

(1) Right to recover all damages:-

⇒ All damages which he may be compelled to pay in any suit in respect of

any matter to which the promise to indemnify applies.

(2) Right to recover costs suit :-

⇒ All costs which he may be compelled to pay in bringing or defending such suits.

(3) Right to recover other sums :-

⇒ All sums, which he may have paid under the terms of any compromise of any such suit.

* Contract of Guarantee (Sec. 125) :-

⇒ A 'Contract of guarantee' is a contract to perform the promise; or discharge the liability, of a third person in case of his default.

* Parties to Contract of Guarantee (Sec. 126) :-

(1) **Surety**: The person who gives the guarantee is called as 'Surety'.

(2) **Principal Debtor** :- The person in respect of whose default the guarantee is given is called as 'Principal Debtor'.

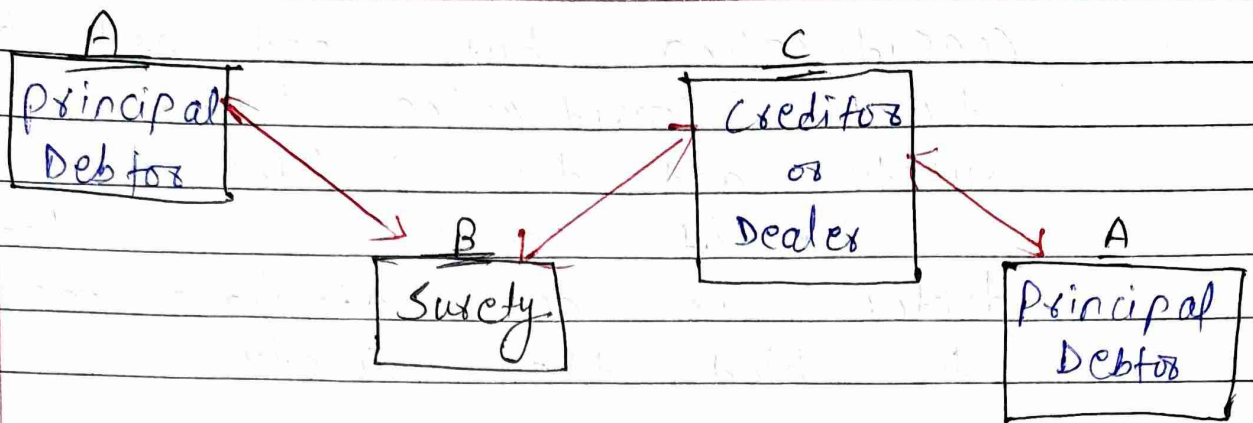
(3) Creditor:- The person to whom the guarantee is given is called as 'creditor'.

Example 3:- Sandeep requests Chaman to lend Rs. 10,000 to Prashant and guarantees that Prashant will pay the amount within the agreed time and if Prashant does not pay, he (Sandeep) will himself pay to Chaman. There is a contract of guarantee. Here, Chaman is the creditor, Prashant is the principal debtor and Sandeep is the surety.

Example 4:- 'S' asks 'C' to sell a table fan to 'P' and agrees that if 'P' fails to pay he will. In case 'P's' failure to pay, the 'C' will recover its money from 'S'.

• Analysis of Definition of Contract of Guarantee:-

e) There are three contracts b/w principal debtor, creditor and surety.



* Essentials for a valid contract of guarantee :-

(1) Principal Debt :- The purpose of guarantee should be to secure the payment of a debt if there is no debt, there can be no valid guarantee.

(2) Existence of liability :- The debt or liability must be legally enforceable and not time barred.

Example 5 :- A gives the guarantee to B for the payment of time-bassed debt due from C. This is not a valid contract.

(3) Consideration :- Contract of guarantee should be supported by some

consideration but need not be direct consideration between the surety and the creditor. Any benefit received by the debtor is an adequate consideration to bind the surety.

Example 6:- 'P' requests 'C' to sell and deliver to him 100 kgs sugar on credit. 'S' guarantees the payment. Here, 'C's' promise to deliver the goods to 'P' is a sufficient consideration for 'S's' promise. Therefore, the guarantee is valid.

(4.) No misrepresentation or concealment:-

=> There should not be any misrepresentation or concealment in contract of guarantee.

Example 7:- 'S' guarantees to 'C' payment for 100 quintals of wheat to be supplied by him to 'P' at market price. 'P' privately agreed that 'P' should pay Rs. 10 per quintal extra to 'C' which is not in the knowledge of 'S'. Now there is concealment of facts from 'S'. Hence, 'S' is not liable as a surety.

(5) A contract of guarantee may be written or oral.

(6) Joining of the other co-sureties (sec. 144):-

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

* Types of Guarantee :-

⇒ There are two types of Guarantee :-
(i) Specific Guarantee.
(ii) Continuing Guarantee.

(i) Specific Guarantee :-

⇒ Guarantee which extends to a single debt/ specific transaction.

⇒ Surety's liability comes to an end when the guaranteed debt is duly discharged.

(ii) Continuing Guarantee :-

- Guarantee which extends to a series of transactions.
- Surety's liability continues until the revocation of the guarantee.
- Continuing guarantee is intended to cover a number of transactions over a period of time. But a guarantee for one specific transaction comes to an end as soon as the liability under that transaction ends.

Kay vs. Groves
130 ER 1287.

→ Not liable.

(A)

I guarantee for the payment to the amount of 5 sacks of flour to be delivered to B, payable in month.

(C)

Delivers only one bag of flour.



(B)

failed to pay to C.

Example 8:- Awdhesh guarantees Mukesh, a ~~ertain~~ canteen owner, to supply lunch to his employee for time to time upto the value of Rs. 10,000. The guarantee given by Awdhesh was a continuing guarantee, and he is accordingly liable to Mukesh to the extent of Rs. 10,000.

* Distinction between A contract of indemnity & Guarantee.

Basis.	Contract of Indemnity.	Contract of guarantee.
Parties	Only two parties	Three parties.
Contracts	One contract	Three contracts.
Primary liability	liability of indemnifier is primary and independent.	liability of surety is secondary and of principal debtor is primary.
Consequence of liability	Arise only on the happening of a contingency.	Arise only on default by principal debtor.
Time of Act.	The indemnifier need not act at the request of indemnity holder.	The surety acts at the request of principal debtor.
Purpose.	Reimbursement of loss.	For the security of the creditor.

Suit	The indemnifier cannot sue the third party in his own name unless there is an assignment in indemnifier's favour. Otherwise he must bring the suit in the name of indemnified.	If the principal debtor fails to pay and the surety discharges his debt, the surety can proceed against the principal debtor in his own right.
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* Nature and Extent of Surety's liability (sec. 128):-

⇒ The liability of surety is 'co-extensive with that of principal debtor' i.e. the surety is liable for what the principal debtor is liable. However, the contract of guarantee may provide otherwise.

Example 9:- 'x' gives guarantee to 'y' for the payment of a debt of Rs. 10,000 due from 'z'. On the due date, 'z' could not make the payment. An unknown person made a payment of Rs. 2000 to 'y' on behalf of 'z'. Now 'x' is liable to pay Rs. 8000.

⇒ The liability of a surety arises only on default by the principal debtor.

⇒ Where a debtor cannot be held liable on account of any defect in the document the liability of the surety also ceases.

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

* Modes of discharge of surety:-

• By Revocation:-

- ▷ By Notice
- ▷ By surety's death.
- ▷ By Novation

• By Conduct of the Creditors:-

- ▷ By variance of terms.
- ▷ By release or discharge of PD.
- ▷ Composition with PD.
- ▷ Impairing surety's remedy.

• On invalidation of contract of guarantee:-

- ▷ Guarantee obtained by misrepresentation.
- ▷ Guarantee obtained by concealment.
- ▷ Guarantee on contract that creditor shall not act on it until co-surety joins.

* Discharge of Surety by Revocation :-

(a) By Notice :-

- ▶ Specific guarantee :- A specific guarantee can not be revoked, once the liability is incurred.
- ▶ Continuing guarantee :- A continuing guarantee can be revoked only in respect of future transactions.

Example 10 :- 'S' guarantees 'C' for the transaction to be done between 'C' & 'P' for next month. After 5 days 'S' informs 'C' & 'P', he is not the surety any more. Guarantee is revoked for future transactions but 'S' is still surety for transactions done during previous five days.

(b) Death of Surety :-

- ▶ On death of surety, a continuing guarantee is automatically revoked in respect of future transactions.

➤ However, the Surety's estate remains liable for the past transactions which have already taken place before the death of the Surety.

Example 11:- S guarantees C for the transaction to be done between C & P for next month. After 5 days 'S' died. Now guarantee is revoked for future transactions but S's estate is still liable for transactions done during previous five days.

(c) By Novation:-

⇒ When an old guarantee is substituted by a new one, the old guarantee is automatically discharged.

Example 12:- S guarantees C for the payment of supply of wheat to be done by C & P for next month. After 5 days, the contract is changed. Now S guarantees C for the payment of the supply of rice to be done by C & P for rest of next month. Here, guarantee is revoked for supply of wheat. B S is still liable for supply of wheat done during previous five days.

* Discharge of Surety by Conduct of Creditor :-

(a) Variance in terms of Contract (Sec 133) :-

⇒ If subsequent to the formation of ~~conduct~~ contract of guarantee

▷ any variation is made in the terms and conditions of contract of guarantee; and

▷ such variation is made without the consent of Surety;

Then, the Surety shall be released for such transactions as take place after such variations.

Example 13:- 'C' enters in a contract to supply 100 tones of timber to 'P' which was lying in godown of 'C' at Shimla. 'S' gives guarantee to 'C' for payment. Thereafter, 'P' agrees to receive Timber lying at godown at Saton Solan at the request of 'C'. But no consent was taken from 'S' for such change. Held 'S' is discharged.

(b) Release or discharge of principal debtor (Sec. 134, 135) :-

⇒ The surety is discharged if the creditor:

▷ enters into a fresh/new contract with principal debtor; by which principal debtor is released, or

▷ does any act or ~~an~~ omission, the legal consequence of which is the discharge of the principal debtor.

Example 14:- 'P' contracts with 'C' for a fixed price to build a house for 'C' within a stipulated time, 'C' supplying the bricks. 'S' guarantees 'P's' performance of the contract. 'C' did not supply the bricks to 'P'. 'S' is discharged from his surety ship.

(c) Composition with principal debtor (Sec. 135) :-

⇒ The surety is discharged if the creditor:

▷ makes a composition with, or gives time to, ~~to~~ or agrees not to sue, the principal debtor without obtaining the consent of surety.

Example 15:- 'C' sells AC to 'P' on which payment to be made after 2 months. 'S' guarantees for the same as surety. On due date, 'P' request 'C' to extend the time for payment by 15 days. 'C' allows without informing 'S'. Here, 'S' will be discharged.

- Exceptions to point no. C (cases where surety not discharged):-

(i) Surety not discharged when agreement made with third person to give time to principal debtor (sec. 136)

Example 16:- If in the previous example, 'P' request 'C' to extend the time for payment by 15 days, 'S' will not be discharged.

(ii) Creditor's forbearance to sue does not discharge surety (sec. 137)

Example 17:- 'C' sells AC to 'P' on which payment to be made after 2 months. 'S' guarantees for the same as surety. On due date, 'P' did not make the payment. 'C' did not sue 'P' for a next year. Here 'S' will not be discharged.

(d) Impairing Surety's remedy (Sec. 139):-

⇒ It is the duty of the creditor not to do anything, which is inconsistent with the rights of the surety.

⇒ If the creditor fails to protect the surety's rights, the surety is discharged.

Example 18:- 'C' takes up 'P' as apprentice on a fidelity guarantee given by 'S'. 'C' promises on his part that he will, at least one month, see that 'P' makes up the cash. 'C' omits to see this done as promised, and 'P' embezzles. 'S' is not liable to 'C' on ~~the~~ his guarantee.

* Discharge of Surety on Invalidity of contract of Guarantee :-

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

⇒ The Surety is discharged;

Any guarantee which has been obtained by means of misrepresentation made by the creditor concerning a material part of the transaction.

Example 19:- 'C' sell AC to 'P' on misrepresenting that it is made of copper while it is made of aluminium. 'S' guarantees for the same as surety without the knowledge of fact that it is made of aluminium. Here, 'S' will not be liable.

(b) Guarantee obtained by concealment (s. 143):-

⇒ The surety is discharged:

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

Example 20:- 'S' guarantee to 'C' payment for 100 quintals of wheat to be supplied by him to 'P' at market price. 'P' privately agreed that 'P' should pay Rs. 10 per quintal extra to 'C' which is not in the knowledge of 'S'. Now there is concealment of facts from 'S'. Hence, 'S' is not liable as surety.

(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 upon it until another person has joined in it as co-surety, the guarantee is not valid if that other person does not join.

Example 21:- 'S1' guarantees 'C' for the payment to be done by 'P' to 'C' on the condition that 'S1' will be liable only if 'S2' joins him for such guarantee. 'S2' does not give his consent. Here, 'S1' will not be liable.

* Rights of a surety

• Against principal debtor:-

- Right of Subrogation
- Right of Indemnity

• Against Creditors:-

- Right of Security.
- Right to set off.
- Right to share reduction.

• Against Co-Sureties:-

- ▷ Right to claim contribution equally.
- ▷ Right to claim contribution only agreed sum.

* Rights against principal debtor:-

(a) Right of Subrogation (sec. 140):-

⇒ On payment of a debt, the surety shall be entitled to all the rights which the creditor could claim against principal debtor.

Example 22:- 'Raju' has taken a housing loan from Canara Bank. 'Pappu' has given guarantee for repayment of such loan. Besides, there was a condition that if 'Raju' does not repay the loan within the time, the bank can auction his property by giving 15 days notice to 'Raju'.

On the due date 'Raju' does not repay, hence 'Pappu' being a surety has to repay the loan. Now 'Pappu' can take the house from bank and has a right to auction the house by giving 15 days notice to 'Raju'.

(b) Rights of Indemnity (Sec. 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.

Example 23:- 'X' took a loan from 'Y' which was guaranteed by 'Z'. On default by 'X', 'Y' filed suit against 'Z'. 'Z' has to pay some legal expenses besides loan of 'X'. Now 'Z' can claim those legal expenses from 'X'.

* Right against Creditors:-

(a) Right to get surety (Sec. 141):-

⇒ Surety has right to demand from the creditor all the securities which the creditor has against debtor whether they had been received before, at or after, the creation of the guarantee and whether those are in the knowledge of surety or not.

Example 24:- 'Pratham' took an advance of Rs. 1,00,000 from 'Chaman' which was guaranteed by 'Samax'. Thereafter, 'Pratham' gave jewellery of Rs. 1,00,000 to 'Chaman' as security which was not in the knowledge of 'Samax'. After some time, 'Pratham' became insolvent. 'Chaman' filed the suit against 'Samax'. At that time, the market value of jewellery was Rs. 95,000. Here 'Samax' is liable for Rs. 5000 only.

(b) Right to set off:-

⇒ On being sued by creditor, the surety may have the benefit of the set off, if any, that the principal debtor had against the creditor.

Example 25:- 'X' took a loan of Rs. 5000 from 'Y' which was guaranteed by 'Z'. There was one another contract between 'X' and 'Y' in which 'Y' had to pay Rs. 1000 to 'X'. On the default by 'X', 'Y' filed suit against 'Z'. Now 'Z' is liable to pay Rs. 4000 only.

(c) Right to share Reduction:-

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

Example 26:- 'X' took a loan of Rs. 5000 from 'Y' which was guaranteed by 'Z'. 'X' ~~becomes~~ became insolvent and only 25% is realised from his property against liabilities. Now 'Y' will receive Rs. 1250 from 'X' and Now 'Z' is liable to pay Rs. 3750.

* Right against Co-Sureties:-

(a) Right to claim Contribution equally (Sec. 140):

⇒ Unless otherwise agreed, each Surety is liable to contribute equally for discharge of whole debt or part of the debt remains unpaid by debtor.

Example 27:- 'X', 'Y' and 'Z' had given the guarantee for a loan of Rs. 30,000 which was lent 'L' to 'M'. Now in case M defaults 'X', 'Y' and 'Z' will be liable for Rs. 10,000 each.

(b) Right to claim contribution only agreed sum (sec. 147):-

⇒ If Co-sureties have guaranteed for different sums, they are liable to pay equally as far as the limits of their respective obligations permit.

Example 28:- 'X', 'Y' and 'Z' are sureties to 'M', enter into three several bonds, each in different penalty, 'X' in the penalty of Rs. 10,000, 'Y' in that of Rs. 15,000 and 'Z' in that Rs. 30,000. Now in case 'M' default to the extent of Rs. 30,000. Here 'X', 'Y' and 'Z' will be liable for Rs. 10,000 each.

Example 29:- In case 'M' defaults to the extent of Rs. 40,000. Here, 'X' will be liable for Rs. 10,000, 'Y' and 'Z' will be liable for Rs. 15,000 each.

Example 30:- In case 'M' defaults to the extent of Rs. 50,000. Here 'X' will be liable for Rs. 10,000, 'Y' will be liable for Rs. 15,000 and 'Z' will be liable for Rs. 25,000.

END