

Unit 7 - Contract of Indemnity and Guarantee

* Contract of Indemnity [Sec. 124]

- Indemnity means → 'Security against loss' or 'to make good the loss'.
- 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.
- Scope:-
 - Restricted to loss caused by promisor himself or any other person.
 - Loss occasioned by accident / act of god is not recovered
 - EXCEPTION ⇒ Gajanan Moreswar v/s Moreswar Madan (1942)

• Parties to Contract of Indemnity:-

- (i) Party who promises to indemnify / save the other party from loss ⇒ 'Indemnifier'
- (ii) Party who is promised to be saved against the loss ⇒ 'Indemnified' or 'Indemnity Holder'.

• Mode of Contract of Indemnity:-

- (i) Express - When a person expressly promises to compensate the other from loss.
- (ii) Implied - When it is inferred from conduct of parties or from the circumstances of the case.

- Contract of Indemnity must fulfill all essentials of valid contract.
- Fire and Marine Insurance = Contract of Indemnity
- Life Insurance = not Contract of Indemnity

• Rights of Indemnity holder when sued (Sec. 125)

→ He is entitled to recovery - all the damages, costs of suit and other sums

• When does the liability of Indemnifier commence?

→ Liability of Indemnifier commences as soon as the liability of indemnity holder becomes absolute and certain.

• Contract of Guarantee [Sec. 126]

→ A contract to perform the promise made or discharge the liability, of a third person in case of his default.

• Parties to Contract of Guarantee :-

(i) Surety ⇒ The person who gives guarantee

(ii) Principal Debtor ⇒ person in respect of whose default the guarantee is given.

(iii) Creditor ⇒ person to whom the guarantee is given

• Tripartite Agreement between parties involved :-

(i) Principal contract → between principal debtor and creditor

(ii) Secondary contract → between creditor and surety

(iii) Implied contract → between surety and principal debtor

• Essential Features of a Valid Guarantee :-

(i) Purpose ⇒ to secure the payment of debt

(ii) Consideration ⇒ must be there ⇒ may be direct / indirect

(iii) Existence of Liability ⇒ Liability must be legally enforceable, not time barred

(iv) No misrepresentation / concealment

(v) May be oral / written

(vi) Joining of co-surety ⇒ If condition is imposed for other surety to join, then he must just

* Types of Guarantee :-

(i) Specific Guarantee

- Guarantee which extends to single debt / specific transaction
- Surety's liability ends when the debt is discharged

(ii) Continuing Guarantee (Sec. 129)

- Guarantee which extends to a series of transactions
- Surety's guarantee continues until revocation of guarantee

• Nature and Extent of Surety's Liability :-

- (i) Co-existence with that of the principal debtor unless otherwise provided.
- (ii) Secondary in nature → liable only if default by principal debtor
- (iii) Where a debtor cannot be held liable because of defect in document, the liability of surety also ceases.
- (iv) A creditor may choose to proceed against a surety first.

Mode of Discharge of a Surety

↓
By Revocation

↓
By conduct of
Creditor

↓
On Invalidation of
Contract of Guarantee

1.) By Revocation of Contract of Guarantee

(Sec. 130)

(a) By Notice - • continuing guarantee may be revoked by surety for future transaction.

- Past transaction liability remains
- Specific guarantee can only be revoked if liability is not accrued.

(b) By Surety's death (Sec. 131) - Estate remains liable for past transactions.

(c) By Novation (Sec. 62)

2.7 By conduct of the Creditor

(a) Variance in terms of contract - without assent of the surety (Sec. 133)

(b) By release/discharge of principal debtor (Sec. 134)

→ discharged if creditor enters into fresh/new contract or does any act/ommission which leads to discharge of principal debtor.

(c) By composition, creditor promise to give more time and promise not to sue principal debtor (Sec. 135)

(d) By creditor's act or omission impairing surety's eventual remedy (Sec. 139)

3.7 By the invalidation of the contract of Guarantee

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

(b) Guarantee obtained by concealment (Sec. 143)

(c) Guarantee on the contract that creditor shall not act until co-surety join. Such co-surety does not join. (Sec. 144)

* Rights of Surety

1.7 Rights against co-sureties

• When the same debt or duty is guaranteed by two or more persons. Such person as called Co-Sureties

(a) Co-sureties liable to contribute equally - Each surety is liable to contribute equally. [Sec. 146]

(b) Liability bound in different sums - principle of equal contribution is subject to maximum limit fixed by surety of his liability. [Sec. 147]

2.) Rights against Principal Debtor

- (a) Rights of Subrogation [Sec. 140] - on the payment of the guaranteed debt / performance of the guaranteed duty, surety steps into the shoes of the creditor.
- (b) Implied promise to indemnify Surety [Sec. 145] - The surety is entitled to recovery from Principal Debtor whatever sum he has rightfully paid under guarantee, but not sums which he paid wrongfully.

3.) Rights against the Creditor

- (a) Surety's right to benefit of creditor's securities [Sec. 141]
- entitled to benefit of every security which creditor has against Principal Debtor, whether surety is aware of its existence or not
 - If creditor loses or parts with security without consent of surety, surety is discharged to extent of value of such security.
- (b) Right to set off - Surety has benefit to claim set off, if principal debtor had any against the creditor.
- (c) Right to share reduction - Surety has right to claim proportionate reduction in the liability if Principal Debtor becomes insolvent.

Cases where Surety is not discharged :-

- (i) When the agreement is made by creditor with third person, not with Principal Debtor, to give more time to principal debtor [Sec. 136]
- (ii) Mere forbearance on the part of creditor to sue the principal debtor or enforce any remedy against him. [Sec. 137]