

CHAPTER 1

THE INDIAN CONTRACT ACT, 1872

UNIT 1 : CONTRACT OF INDEMNITY AND GUARANTEE

INDEMNITY

- 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, is called a contract of indemnity (**Section 124**).
- The person who promises to make good the loss is called 'indemnifier' and the person whose loss is to be made good is called the 'indemnified' or 'indemnity-holder'.
- A contract of indemnity is like any other contract and must, therefore, fulfill all the essentials of a valid contract, e.g., consideration, free consent, competency of parties, lawful object, etc.
- A contract of Fire Insurance or Marine Insurance is always a contract of indemnity. But there is no contract of indemnity in case of contract of Life Insurance.
- It is a contingent contract.
- Indemnifier cannot sue third party on his own unless
- **Rights of indemnity holder (Section 125) :**
An indemnity holder acting within the scope of his authority is entitled to the following rights:
 - (a) Right to recover damages
 - (b) Right to recover cost of litigation
 - (c) Right to recover sums paid under compromise

GUARANTEE

- **MEANING (Sec. 126):**
 - 'A contract of guarantee' is a contract to perform the promise, or discharge the liability, of a third person in case of his default.
 - The person who gives the guarantee is called the 'surety', the person in respect of whose default the guarantee is given is called 'principal debtor', and the person to whom the guarantee is given is called 'the creditor'.
 - A guarantee may be either oral or written.
 - According to **Sec 127** no consideration is required for contract of guarantee. In other words anything done or any promise made for the benefit of the principal Debtor may be sufficient consideration for the surety for giving guarantee to the Creditor.
- **ESSENTIALS OF A VALID GUARANTEE**
 1. Existence of a principal debt.
 2. Benefit to principal debtor is sufficient consideration, but past consideration is

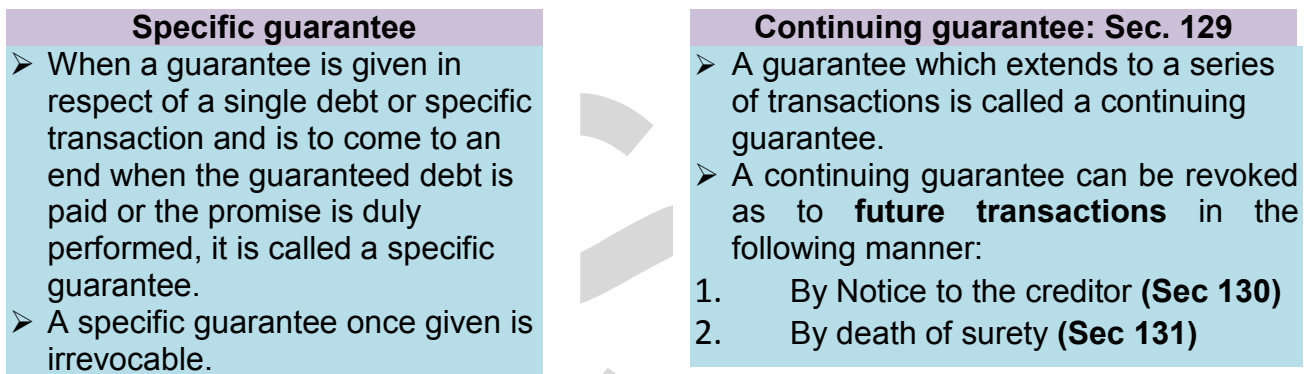
no consideration for a contract of guarantee.

3. Consent of surety should not be obtained by misrepresentation or concealment of a material fact.
4. Can be oral or written.
5. Surety can be proceeded against without proceeding against the principal debtor first if the contract specifies.
6. If the co-surety does not join, the contract of guarantee is not valid.

• **NATURE OF SURETY'S LIABILITY**

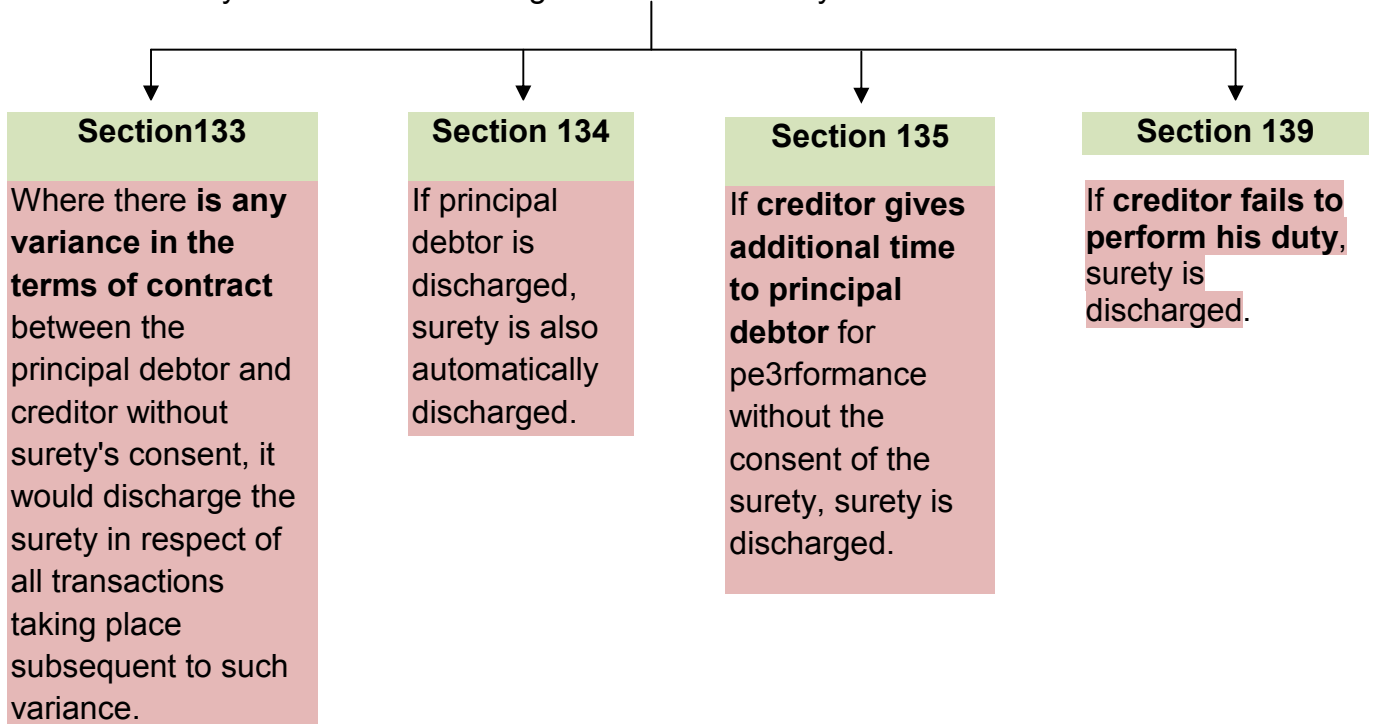
As per Section 128 of the Act, the liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract.

• **KINDS OF GUARANTEE**



• **DISCHARGE OF SURETY**

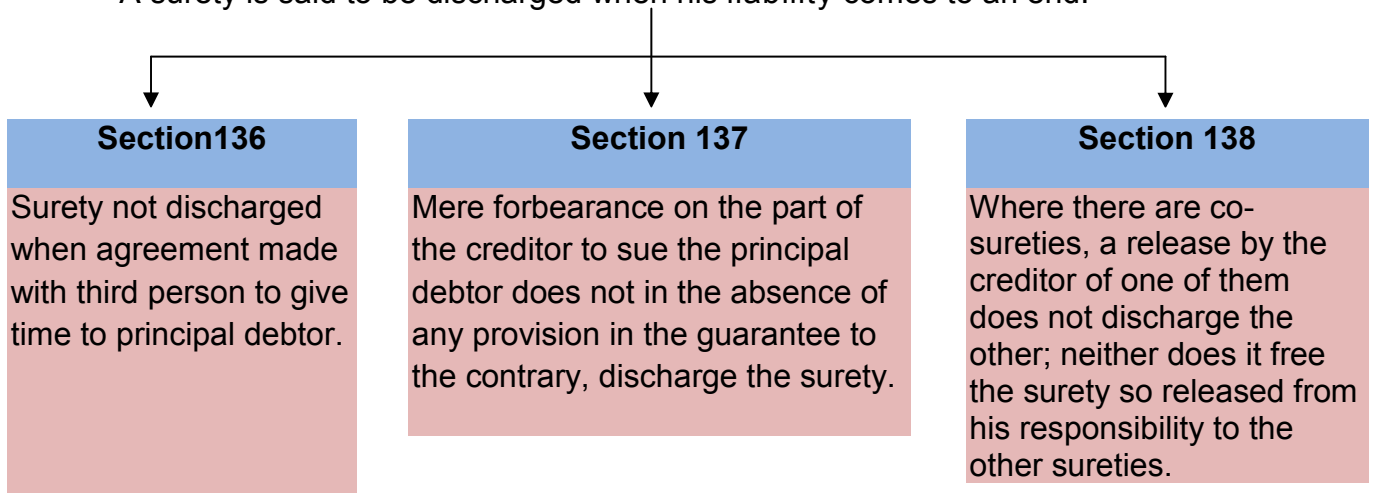
A surety is said to be discharged when his liability comes to an end.



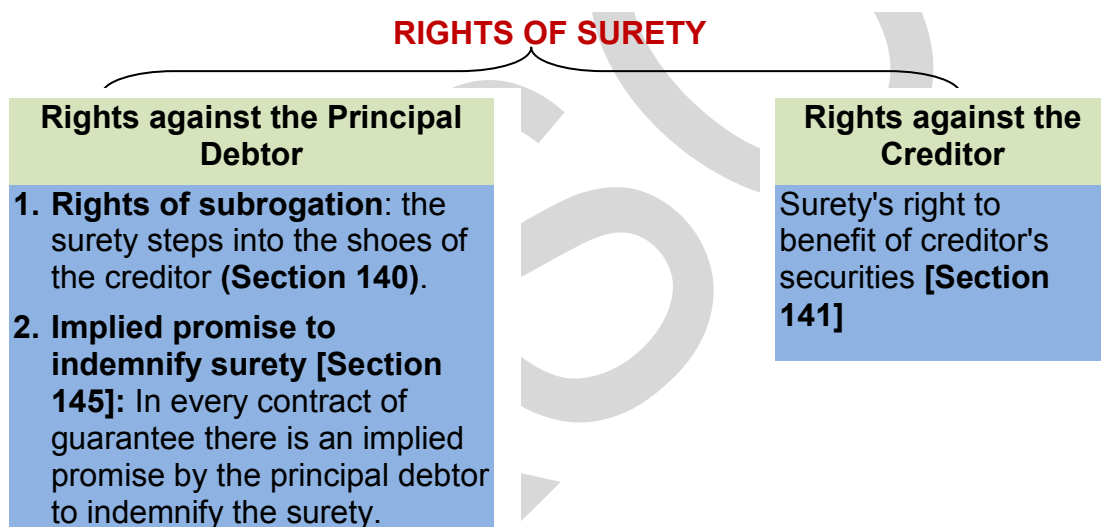
• **NON-DISCHARGE OF SURETY**

The surety is not discharged in the following cases:

A surety is said to be discharged when his liability comes to an end.



• **RIGHTS OF SURETY**



• **INVALID GUARANTEE [SEC 142 to 144]**

- (a) Guarantee obtained by misrepresentation invalid **[Section 142]**
- (b) Guarantee obtained by concealment invalid **[Section 143]**
- (c) Where more than 1 surety is required, guarantee given by only 1 surety is invalid until others join **[Section 144]**.

• **CONTRIBUTION OF CO-SURETIES**

When a debt is guaranteed by two or more sureties they are called as co-sureties. They are liable to contribute as agreed towards the payment of the guaranteed debt.

The following are the rules:-

- (1) **Co-sureties liable to contribute equally. [Sec 146]**
Liability of co-sureties, bound in different sums: [Sec 147]: Where the co-sureties have agreed to guarantee different sums , they have to contribute in the agreed ratio.
- (2) **Sureties' liability towards other co-sureties [Sec 138]:** Creditor may sue any one of the co-sureties or he may release any of the co-sureties from the liability. However this does not free the surety so released from his liability

towards the other co-sureties.

- (3) **Mutual agreement between co-sureties [Section 132]:** Any understanding/mutual agreement between debtors interse that one of them only shall be liable as a surety will not affected the rights of the creditor in any way even if the creditor knew the arrangement between the debtors.

DISTINCTION BETWEEN INDEMNITY AND GUARANTEE

Point of distinction	Contract of Indemnity	Contract of Guarantee
Number of parties/ Parties to the contract	There are only two parties namely the indemnifier [promisor] and the indemnified [promisee]	There are three parties creditor, principal debtor and surety.
Nature of liability	The liability of the indemnifier is primary and independent	The liability of the surety is secondary as the primary liability is that of the principal debtor.
Time of liability	The liability of the indemnifier arises only on the happening of a contingency.	Liability is already in existence but specifically crystallizes when principal debtor fails.
Time to Act	The indemnifier need not necessarily act at the request of indemnified	Surety must act by extending guarantee at the request of 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 debts.
Purpose	Reimbursement of loss	For the security of the creditor
Competency to contract	All parties must be competent to contract	In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid.
Number of Contracts	Only one original and independent contract between indemnifier and indemnified.	There are 3 contracts made between- <ul style="list-style-type: none"> • Creditor and principal debtor • Creditor and Surety • Surety and Principal debtor
