

# Unit 7 - Contract of Indemnity & Guarantee

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## Unit 7:- Contract of Indemnity and Guarantee

### Contract of Indemnity :-

It 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."

### Scope:-

Restricted to loss caused by himself or any other person. Loss occasioned by accident/act of god is not covered.

Exception - Gajanan Moreshwar v/s Moreshwar Madan (1942)

### Parties to Contract of Indemnity :-

- 1) The party who promises to indemnify/save the other party from loss- "indemnifier",
- 2) The party who is promised to be saved against the loss- "indemnified" or "indemnity holder".

### Mode of Contract of indemnity :-

1. Express - when a person expressly promises to compensate the other from loss.
2. Implied - when it is inferred from conduct of parties or from the circumstances of the case.

Contract of indemnity must fulfil all the essentials of valid contract.

Fire and marine insurance - contract of indemnity

Life insurance - not a contract of indemnity

### Rights of indemnity holder when sued :-

He is entitled to recover - all the damages, costs of suit, other sums.

Liability of indemnifier - commences as soon as the liability of indemnity holder becomes absolute and certain.

## Contract of 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.

## Three Parties Involved:-

- 1) Surety - person who gives guarantee.
- 2) Principal debtor - person in respect of whose default the guarantee is given.
- 3) Creditor - person to whom the guarantee is given.

## Tripartite agreement between parties involved:-

- 1) Principal contract - between principal debtor and creditor
- 2) Secondary contract - between creditor and surety
- 3) Implied contract - between surety and principal debtor.

## Essential features of Guarantee:-

1. **Purpose** :- To secure payment of debt.
2. **Consideration** must be there - may be direct/indirect
3. **Existence of liability** - Liability must be legally enforceable, not time barred
4. No misrepresentation/concealment
5. May be oral/written
6. Joining of co-surety - if condition is imposed for other surety to join then he must join.

## Types of Guarantee

### Specific Guarantee:-

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

### Continue Guarantee:-

- Guarantee which extends to a series of transaction
- Surety's liability continues until revocation of guarantee.

## Nature and Extent of Surety's liability :-

1. Co - Extensive with that of the principal debtor unless otherwise provided.
2. Secondary in nature - liable only if default by principal debtor
3. Where a debtor cannot be held liable because of defect in document, the liability of surety also ceases.
4. A creditor may choose to proceed against a surety first.

## Modes of discharge

### By Revocation of guarantee :-

- 1) 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.
- 2) By Surety's death :- Estate remains liable for past transactions.
- 3) By Novation

### By Conduct of Creditor:-

- 1) Variance in terms without assent of surety.
- 2) By release/discharge of principal debtor(PD) - discharged if creditor enters into fresh/new contract or does any act/omission which leads to discharge of PD.
- 3) By composition, promise to give time and promise not to sue with PD.
- 4) By Creditor's act/omission impairing surety's eventual remedy.

### On Invalidation of contract of Guarantee:-

1. Guarantee obtained by misrepresentation.
2. Guarantee obtained by concealment
3. Guarantee on the contract that creditor shall not act until co surety join. Such co surety does not join.

Cases where surety is **not** discharged

1. When agreement is made by creditor with third person not with PD to give time to PD
2. Mere forbearance on the part of creditor to sue the PD or enforce any remedy against him.

## Rights of Surety

**Rights against principal debtor:-**

- 1) Rights of subrogation:- On the payment of the guaranteed debt/performance of the guaranteed duty, surety steps into the shoes of the creditor.
- 2) Implied promise to indemnify surety:- The surety is entitled to recover from PD whatever sum he has rightfully paid under guarantee, but not sums which he paid wrongfully.

**Rights against co sureties:-**

["Co-sureties (meaning)- When the same debt or duty is guaranteed by two or more persons, such persons are called co-sureties" ]

- 1) Co-Sureties liable to contribute equally - Each surety is required to contribute equally.
- 2) Liability bound in different sums - principle of equal contribution is subject to maximum limit fixed by surety of his liability.

**Right against Creditor:-**

- 1) Surety's right to benefit of creditor's securities:- Entitled to benefit of every security which creditor has against PD 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.
- 2) Right to set off:- Surety has benefit to claim set off if the PD had any against the creditor.
- 3) Right to share reduction:- Surety has right to claim proportionate reduction in the liability if PD becomes insolvent.