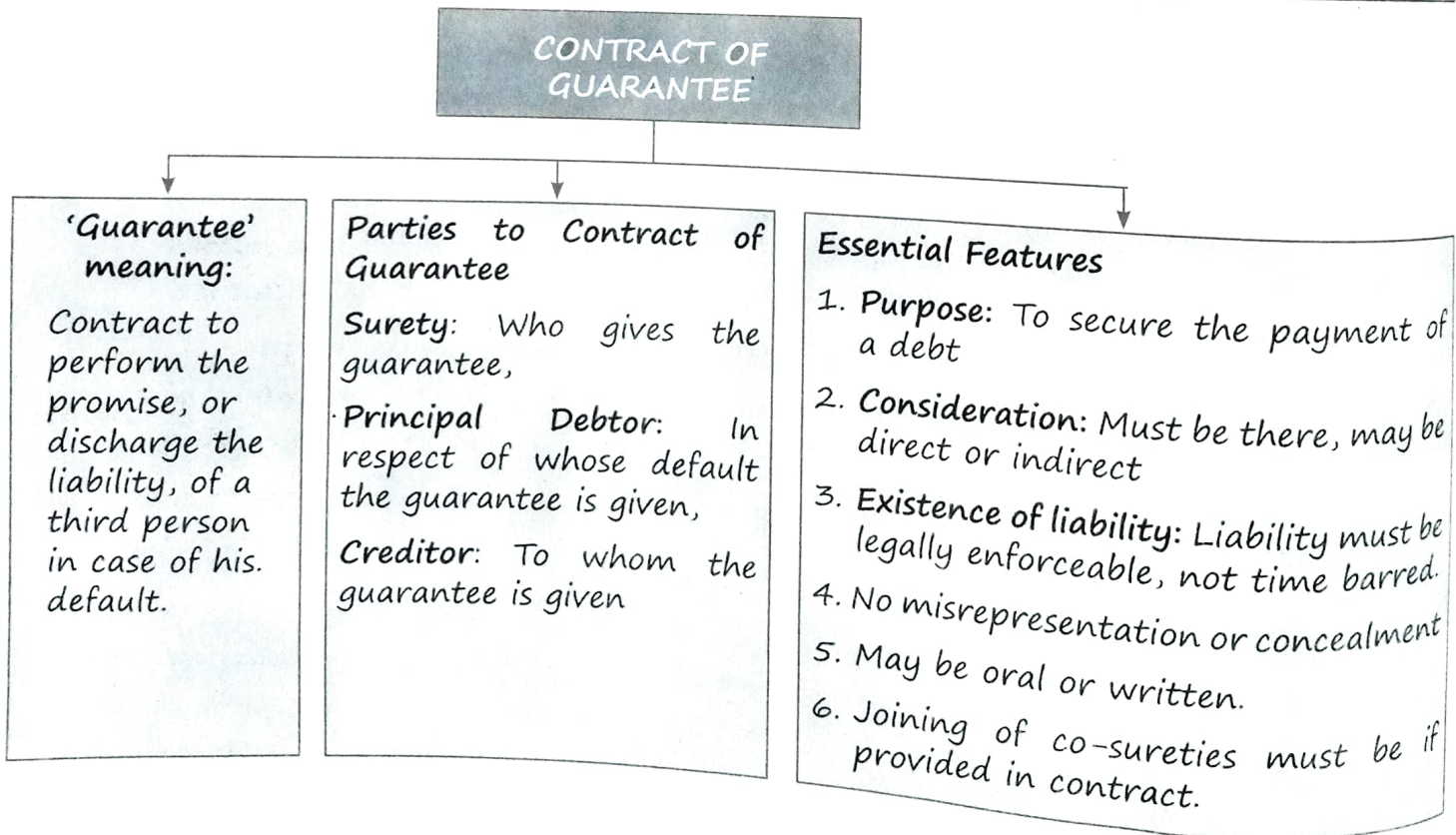
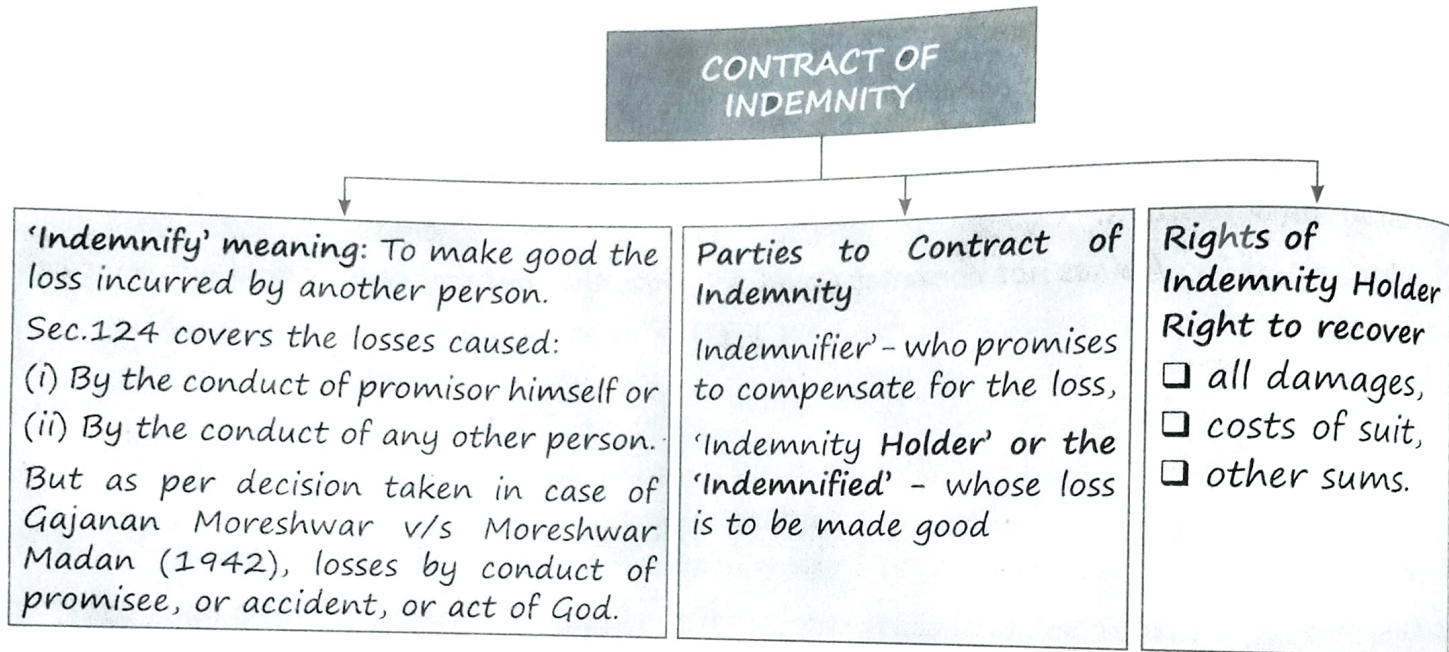


# Contract of Indemnity and Guarantee

## PART-A



## Types of Guarantee

### Specific Guarantee

1. Guarantee which extends to a single debt/ specific transaction,
2. Surety's liability comes to an end when guaranteed debt is duly discharged.

### Continue Guarantee

1. Guarantee which extends to series of transaction,
2. Surety's liability continues until the revocation of the guarantee,

## Modes of Discharge of Surety

### By Revocation

1. By Notice,
2. By surety's death,
3. By Novation,

### By Conduct of Creditors

1. By variance in terms,
2. By release or discharge of PD,
3. Composition with PD,
4. Impairing surety's remedy,

### On Invalidation of Contract of Guarantee

1. Guarantee obtained by misrepresentation,
2. Guarantee obtained by concealment,
3. Guarantee on contract that creditor shall not act on it until co-surety joins

## Rights of Surety

### Against Principal Debtor

1. Right of subrogation
2. Right of Indemnity,

### Against Creditor

1. Right to Security
2. Right to Set Off
3. Right to share reduction

### Against Co-Surities

1. Right to claim contribution equally,
2. Right to claim contribution only agreed sum

## PART-B

Q1. S asks R to beat T and promises to indemnify R against the consequences. R beats T and is fined ₹ 50,000. Can R claim ₹ 50,000 from S.

Sol.

### Provision

A contract of indemnity to be valid must fulfil all the essentials of a valid contract which includes:

- (a) Offer and acceptance
- (b) Intention to create legal obligation
- (c) Consideration
- (d) Competency to contract
- (e) Free consent
- (f) Lawful object
- (g) The agreement must not be expressly declared to be void. Eg: Agreement in restraint of trade
- (h) The terms of the agreement must not be vague or uncertain
- (i) The agreement must be capable of performance - An agreement to do an impossible act is void.
- (j) Legal formalities

### Analysis and conclusion

R cannot claim ₹ 50,000 from S because the object of the agreement was unlawful.

Q2. State the rights of the indemnity-holder when sued?

Sol. According to the Section 125 of the Indian Contract Act, 1872 the indemnity holder i.e., promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor:

- (i) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies.
- (ii) all costs which he may be compelled to pay in any such suit, if in bringing or defending it, he did not contravene the orders of the promisor, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit.
- (iii) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit.

Section 125 is by no means exhaustive, which deals only with his rights in the event of his being sued. The indemnity holder has other rights besides those mentioned above. If he has incurred a liability and that liability is absolute, he is entitled to call upon his indemnifier to save him from that liability and to pay it off.

Q3. Define 'Contract of Indemnity' as per the Indian Contract Act, 1872. What are the parties to a contract of indemnity? Give an example to explain the contract of indemnity.

Sol. According to section 124 of the Indian Contract Act, 1872, 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".

There are two parties in this form of contract. The party who promises to indemnify save the other party from loss is known as 'indemnifier', whereas the party who is promised to be saved against the loss is known as 'indemnified' or indemnity holder.

**Example:** A may contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a sum of ₹5000/- advanced by C to B. In consequence, when B who is called upon to pay the sum of money to C fails to do so, C would be able to recover the amount from A as provided in Section 124.

Q4. Define contract of indemnity and contract of guarantee and state the conditions when guarantee is considered invalid?

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Sol. Section 124 of the Indian Contract Act, 1872 says that "A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or the conduct of any person", is called a "contract of indemnity".

Section 126 of the Indian Contract Act says that "A contract to perform the promise made or discharge liability incurred by a third person in case of his default." is called as "contract of guarantee".

The conditions under which the guarantee is invalid or void are stated in section 142, 143 and 144 of the Indian Contract Act are:

- (i) Guarantee obtained by means of misrepresentation.
- (ii) Creditor obtained any guarantee by means of keeping silence as to material circumstances.
- (iii) When contract of guarantee is entered into on the condition that the creditor shall not act upon it until another person has joined in it as co-surety and that other party fails to join as such.

Q5. Distinguish between a contract of Indemnity and a contract of Guarantee as per The Indian Contract Act, 1872.

Sol.

1 Point of distinction	Contract of Indemnity	Contract of Guarantee
Number of party/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 unconditional.	The liability of the surety is secondary and conditional 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.	The liability arises only on the non performance of an existing promise or non-payment of an existing debt.
Time to act	The indemnifier need not act at the Request of indemnity holder	The surety acts at the request of principal 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

Q6. Paul (minor) purchased a smart phone on credit from a mobile dealer on the surety given by Mr. Jack, (a major). Paul did not pay for the mobile. The mobile dealer demanded the payment from Mr. Jack because the contract entered with Paul (minor) is void. Mr. Jack argued that he is not liable to pay the amount since Paul (Principal Debtor) is not liable. Whether the argument is correct under the Indian Contract Act, 1872? What will be your answer if Jack and Paul both are minor?

Sol. In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid. In the given question, the contract is a valid contract and Jack (major) shall be liable to pay the amount even if Paul (Principal debtor) is not liable (as Paul is minor). If both Jack and Paul are minors then the agreement of guarantee is void because the surety as well as the principal debtor are incompetent to contract.

Q7. 'Surendra' guarantees 'Virendra' for the transactions to be done between 'Virendra' & 'Jitendra' during the month of March, 2021. 'Virendra' supplied goods of ₹30,000 on 01.03.2021 and of ₹20,000 on 03.03.2021 to 'Jitendra'. On 05.03.2021, 'Surendra' died in a road accident. On 10.03.2021, being ignorant of the death of 'Surendra', 'Virendra' further supplied goods of ₹40,000. On default in payment by 'Jitendra' on due date, 'Virendra' sued on legal heirs of 'Surendra' for recovery of ₹90,000. Describe, whether legal heirs of 'Surendra' are liable to pay ₹90,000 under provisions of Indian Contract Act 1872. What would be your answer, if the estate of 'Surendra' is worth of ₹45,000 only?

Sol.

### Provision

According to section 131 of Indian Contract Act 1872, in the absence of a contract to contrary, a continuing guarantee is revoked by the death of the surety as to the future transactions. The estate of deceased surety, however, liable for those transactions which had already taken place during the lifetime of deceased. Surety's estate will not be liable for the transactions taken place after the death of surety even if the creditor had no knowledge of surety's death.

### Analysis and conclusion

In this question, 'Surendra' was surety for the transactions to be done between 'Virendra' & 'Jitendra' during the month of March 2021. 'Virendra' supplied goods of ₹30,000, ₹20,000 and of ₹40,000 on 01.03.2021, 03.03.2021 and 10.03.2021 respectively. 'Surendra' died in a road accident but this was not in the knowledge of 'Virendra'. When 'Jitendra' defaulted in payment, 'Virendra' filed suit against legal heirs of 'Surendra' for recovery of full amount i.e. ₹90,000.

On the basis of above, it can be said in case of death of surety ('Surendra'), his legal heirs are liable only for those transactions which were entered before 05.03.2021 i.e. for ₹50,000. They are not liable for the transaction done on 10.03.2021 even though Virendra had no knowledge of death of Surendra.

Further, if the worth of the estate of deceased is only ₹45,000, the legal heirs are liable for this amount only.

Q8. Megha advances to Nisha ₹5,000 on the guarantee of Prem. The loan carries interest at ten percent per annum. Subsequently, Nisha becomes financially embarrassed. On Nisha's request, Megha reduces the interest to six per cent per annum and does not sue Nisha for one year after the loan becomes due. Nisha becomes insolvent. Can Megha sue Prem?

Decide your answer in reference to the provisions of the Contract Act, 1872.

Sol.

### Provision

According to section 133 of the Indian Contract Act, 1872, where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

### Analysis and Conclusion

Here, in the given situation, Megha cannot sue Prem, because a surety is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor, no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety.

Q9. Mr. Shashank, is employed as a cashier on a monthly salary of ₹10,000 by XYZ bank for a period of three years. Yash gave surety for Shashank's good conduct. After nine months, the financial position of the bank deteriorates. Then Shashank agrees to accept a lower salary of ₹5,000/- per month from Bank. Two months later, it was found that Shashank has misappropriated cash since the time of his appointment. What is the liability of Yash? Decide your answer in reference to the provisions of the Contract Act, 1872.

Sol.

Till the variation

### Provision

According to section 133 of the Indian Contract Act, 1872, where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

Thus, if the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change.

### Analysis and Conclusion

In the instant case Yash is liable as a surety for the loss suffered by the bank due to misappropriation of cash by Shashank during the first nine months but not for misappropriations committed after the reduction in salary.

Q10. A contracts with B for a fixed price to construct a house for B within a stipulated time. B would supply the necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C discharged from his liability?

Sol.

### Provision

According to section 134 of the Indian Contract Act, 1872, the surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

### Analysis and Conclusion

In the given case, B does not supply the necessary material as per the agreement. Hence, C is discharged from his liability.

Q11. Mr. Chetan was appointed as Site Manager of ABC Constructions Company on a two years contract at a monthly salary of ₹50,000. Mr. Pawan gave a surety in respect of Mr. Chetan's conduct. After six months the company was not in position to pay ₹50,000 to Mr. Chetan because of financial constraints. Chetan agreed for a lower salary of ₹30,000 from the company. This was not communicated to Mr. Pawan. Three months afterwards it was discovered that Chetan had been doing fraud since the time of his appointment. What is the liability of Mr. Pawan during the whole duration of Chetan's Appointment.

Sol.

### Provision

As per the provisions of Section 133 of the Indian Contract Act, 1872, if the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change.

### Analysis and conclusion

In the instant case, Mr. Pawan is liable as a surety for the loss suffered by ABC Constructions company due to misappropriation of cash by Mr. Chetan during the first six months but not for misappropriations committed after the reduction in salary.

Hence, Mr. Pawan, will be liable as a surety for the act of Mr. Chetan before the change in the terms of the contract i.e., during the first six months. Variation in the terms of the contract (as to the reduction of salary) without consent of Mr. Pawan, will discharge Mr. Pawan from all the liabilities towards the act of the Mr. Chetan after such variation

Q12. <sup>Sandeep</sup> Manoj guarantees for <sup>Gaurav</sup> Ranjan, a retail textile merchant, for an amount of ₹1,00,000, for which Sharma, the supplier may from time to time supply goods on credit basis to Ranjan during the next 3 months.

<sup>Gaurav</sup> After 1 month, <sup>Sandeep</sup> Manoj revokes the guarantee, when Sharma had supplied goods on credit for ₹40,000. Referring to the provisions of the Indian Contract Act, 1872, decide whether <sup>Sandeep</sup> Manoj is discharged from all the liabilities to Sharma for any subsequent credit supply. What would be your answer in case <sup>Gaurav</sup> Ranjan makes default in paying back Sharma for the goods already supplied on credit i.e. ₹40,000?

Sol.

### Provision

**Discharge of Surety by Revocation:** As per section 130 of the Indian Contract Act, 1872 a specific guarantee cannot be revoked by the surety if the liability has already accrued. A continuing guarantee may, at any time, be revoked by the surety, as to future transactions, by notice to the creditor, but the surety remains liable for transactions already entered into.

### Analysis and conclusion

As per the above provisions, liability of Manoj is discharged with relation to all subsequent credit supplies made by Sharma after revocation of guarantee, because it is a case of continuing guarantee.

However, liability of Manoj for previous transactions (before revocation) i.e. for ₹40,000 remains. He is liable for payment of ₹40,000 to Sharma because the transaction was already entered into before revocation of guarantee.



Q13. ✓ C, the holder of an over due bill of exchange drawn by A as surety for B, and accepted by B, contracts with X to give time to B. Is A discharged from his liability?  
Sol.

### Provision

According to Section 136 of the Indian Contract Act, 1872, where a contract to give time to the principal debtor is made by the creditor with a third person and not with the principal debtor, the surety is not discharged.

### Analysis and conclusion

In the given question the contract to give time to the principal debtor is made by the creditor with X who is a third person. X is not the principal debtor. Hence, A is not discharged.

Q14. ✓ 'A' gives to 'M' a continuing guarantee to the extent of ₹8,000 for the fruits to be supplied by 'M' to 'S' from time to time on credit. Afterwards 'S' became embarrassed and without the knowledge of 'A', 'M' and 'S' contract that 'M' shall continue to supply 'S' with fruits for ready money and that payments shall be applied to the then existing debts between 'S' and 'M'. Examining the provision of the Indian Contract Act, 1872, decide whether 'A' is liable on his guarantee given to M.

Sol.

### Provision

Discharge of surety by variance in terms of contract: The problem asked in the question is based on the provisions of the Indian Contract Act, 1872 as contained in Section 133. The section provides that any variance made without the surety's consent in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.

### Analysis and conclusion

In the given problem, 'M' and 'S' entered into arrangement by entering into a new contract without knowledge of the Surety 'A'. Since, the variance made in the contract is without the surety's consent in the existing contract, as per the provision, 'A' is not liable on his guarantee for the fruits supplied after this new arrangement. The reason for such a discharge is that the surety agreed to be liable for a contract which is no more there now and he is not liable on the altered contract because it is different from the contract made by him.

Q15. ✓ Mr. Ram was employed as financier in "Swaraj Ltd" on the surety of his good conduct, given by Mr. Janak, a good friend of the director of the company. Mr. Ram was kept on the salary of ₹45,000 per month. After 3 years, the company went into losses and so company decided for the cost cutting by retrenching of many employees and reducing the salaries of the employees. Mr. Ram was also proposed either to quit the job or continued with the lower salary of ₹35,000 per month. He accepted and continued with the job. After few months, it was reported by accounts department of the company that Mr. Ram manipulated with the funds of the company.

As per the provisions of the Indian Contract Act, 1872, analyse the legal positions of Mr. Janak, in the given situations:

- (i) Mr. Ram has manipulated the funds of the company since the time of his appointment.
- (ii) Mr. Ram has manipulated the funds of the company since from few months before when he accepted to continue the job on lower salary.

Sol.

### Provision

Section 133 of the Indian Contract Act, 1872 deals with the provision related to the discharge of the surety. Provisions states that where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent it would discharge the surety in respect of all transactions taking place subsequent to such variance.

### Analysis and conclusion

Following is the answer in the light of the above provision:

- (i) In case where, Mr. Ram has manipulated the funds of the company since the time of his appointment. In this case Mr. Janak is liable as a surety for the loss suffered by the Swaraj Company due to manipulation of the funds by Mr. Ram during the three years of his service.
- (ii) In case where, Mr. Ram has manipulated the funds of the company since from few months before when he accepted to continue the job on lower salary. In this case, variance in the terms of the contract (i.e., to work on lower salary) was made without surety's consent. For all the transactions taking place subsequent to such variance, shall discharge the surety for the loss suffered by the Swaraj company.

Q16) Mr. CB was invited to guarantee an employee Mr. BD who was previously dismissed for dishonesty by the same employer. This fact was not told to Mr. CB. Later on, the employee embezzled funds. Whether CB is liable for the financial loss as surety under the provisions of the Indian Contract Act, 1872?

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11) Mr. X agreed to give a loan to Mr. Y on the security of four properties. Mr. A gave guarantee against the loan. Actually Mr. X gave a loan of smaller amount on the security of three properties. Whether Mr. A is liable as surety in case Mr. Y failed to repay the loan?

Sol.

### Provision

- (i) As per section 143 of the Indian Contract Act, 1872, any guarantee which the creditor has obtained by means of keeping silence as to material circumstances, is invalid.

### Analysis and conclusion

In the given instance, Mr. CB was invited to give guarantee of an employee Mr. BD to the same employer who previously dismissed Mr. BD for dishonesty. This fact was not told to Mr. CB. Here, keeping silence as to previous dismissal of Mr. BD for dishonesty is a material fact and if Mr. BD later embezzled the funds of the employer, Mr. CB entered is invalid in terms of the above provisions.

### Provision

- (ii) As per the provisions of section 133 of the Indian Contract Act, 1872, any variance, made without the surety's consent, in the terms of the contract between the principal [debtor] and the creditor, discharges the surety as to transactions subsequent to the variance.

### Analysis and conclusion

In the given instance, the actual transaction was not in terms of the guarantee given by Mr. A. The loan amount as well as the securities were reduced without the knowledge of the surety.

So, accordingly, Mr. A is not liable as a surety in case Y failed to repay the loan

Q17. Satya has given his residential property on rent amounting to ₹25,000 per month to Tushar. Amit became the surety for payment of rent by Tushar. Subsequently, without Amit's consent, Tushar agreed to pay higher rent to Satya. After a few months of this, Tushar defaulted in paying the rent.

Explain the meaning of contract of guarantee according to the provisions of the Indian Contract Act, 1872. State the position of Amit in this regard.

Sol.

- (i) Contract of guarantee: As per the provisions of section 126 of the Indian Contract Act, 1872, 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 are involved in a contract of guarantee:

- Surety- person who gives the guarantee,
- Principal debtor- person in respect of whose default the guarantee is given,
- Creditor- person to whom the guarantee is given

(ii)

### Provision

According to the provisions of section 133 of the Indian Contract Act, 1872, where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

### Analysis and conclusion

In the instant case, Satya (Creditor) cannot sue Amit (Surety), because Amit is discharged from liability when, without his consent, Tushar (Principal debtor) has changed the terms of his contract with Satya (creditor). It is immaterial whether the variation is beneficial to the surety or does not materially affect the position of the surety.

Q18. Mr. D was in urgent need of money amounting to ₹5,00,000. He asked Mr. K for the money. Mr. K lent the money on the sureties of A, B and N without any contract between them in case of default in repayment of money by D to K. D makes default in payment. B refused to contribute, examine whether B can escape liability under the Indian Contract Act, 1872?

Sol.

Provision

Co-sureties liable to contribute equally (Section 146 of the Indian Contract act, 1872). Equality of burden is the basis of Co-suretyship. This is contained in section 146 which states that "when two or more persons are co-sureties for the same debt, or debt either jointly, or severally and whether under the same or different contracts and whether with or without the knowledge of each other, the co-sureties in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor".

Analysis and conclusion

Accordingly, on the default of D in payment, B cannot escape from his liability. All the three sureties A, B and N are liable to pay equally, in absence of any contract between them.

Q19. 'C' advances to 'B', ₹2,00,000 on the guarantee of 'A'. 'C' has also taken a further security for the same borrowing by mortgage of B's furniture worth ₹2,00,000 without knowledge of 'A'. 'C' cancels the mortgage. After 6 months 'B' becomes insolvent and 'C' sues 'A' his guarantee. Decide the liability of 'A' if the market value of furniture is worth ₹80,000, under the Indian Contract Act, 1872.

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Sol.

Provision

Surety's right to benefit of creditor's securities: According to section 141 of the Indian Contract Act, 1872, a surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and if the creditor loses, or, without the consent of the surety, parts with such security the surety is discharged to the extent of the value of the security.

Analysis and conclusion

In the instant case, C advances to B, ₹2,00,000 rupees on the guarantee of A. C has also taken a further security for ₹2,00,000 by mortgage of B's furniture without knowledge of A. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture i.e. ₹80,000 and will remain liable for balance ₹1,20,000.

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