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Contract of Indemnity :-

Indemnity means Security against loss or to make good the loss or to compensate the party who has suffered some loss.

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.

Parties:-

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

The definition of indemnity restricts the scope of contracts of indemnity in as much as it covers only the loss caused by:-

- i) The conduct of the promisor himself, or
- ii) The conduct of any other person.

Thus, loss occasioned by an accident not caused by any person or an act of God / natural event, is not covered.

Rights of Indemnity - holder when sued :-

The promisee in a contract of indemnity, is entitled to recover from the promisor/indemnifier:-

- all damages which he may be compelled to pay in any suit.
- all costs which he may have been compelled to pay in bringing / defending the suit.
- all sums which he may have paid under the terms of any compromise of suit.

When does the liability of an indemnifier commence?

The liability of an indemnifier commences as soon as the liability of the 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 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.

A Contract of Guarantee is a tripartite agreement between principal debtor, creditor and surety. There are in effect three contracts.

- i) A Principal contract between the principal debtor and the creditor
- ii) A secondary contract between the creditor and the surety.
- iii) An implied contract between the surety and the principal debtor.

Essential elements of a guarantee.

1. **Purpose:-** The purpose of a guarantee being to secure the payment of a debt, the existence of recoverable debt is necessary.
If there is no principal debt, there can be no valid guarantee.

2. Consideration:-

- A guarantee without consideration is void, but there is no need for a direct consideration between the surety and the creditor.
- Consideration received by the principal debtor is sufficient consideration to the surety of giving the guarantee.
- Even if the principal debtor is incompetent to contract, the guarantee is valid. But if surety is incompetent to the contract the guarantee is void.

3. Existence of a liability:-

- There must be an existing liability or a promise whose performance is guaranteed. Such liability or promise must be enforceable by law.
- The liability must be legally enforceable and not time barred.

4. No misrepresentation or concealment:-

Any guarantee which has been obtained by the means of misrepresentation made by the creditor or with his knowledge and assent, concerning a material part of the transaction, is invalid.

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

5. Writing not necessary:-

- A guarantee may be either oral or written.

6. Joining of the other co-sureties:-

- 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.

Types of Guarantee:-

Guarantee may be classified under two categories



Specific Guarantee:-

- A **guarantee** which extends to a single debt / specific transaction is called a **specific guarantee**.



Ankita mam **guarantees** payment of five rice Bags to Pooja mam to be delivered by Pooja mam to Harshad sir and to paid in a month.

Pooja mam delivers five bags to Harshad sir.

Harshad sir pays for them. This is a contract for a **specific guarantee** because Ankita mam intended to **guarantee only for the payment of the price of first five bags** of first five bags to be delivered one time.

Continuing Guarantee:-

A guarantee which extends to a series of transaction is called a continuing guarantee.

Distinction between a contract of Indemnity and a contract of Guarantee.

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
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.

Nature and extent of Surety's liability :

- i] The liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract.
- ii] Liability of surety is of secondary nature as he is liable only on default of principal debtor.
- iii] Where a debtor cannot be held liable on account of any defect in the document, the liability of the surety, also ceases.
- iv] A creditor may choose to proceed against a surety first

Liability of two persons, primarily liable, not affected by arrangement between them that one shall be surety on other's default.

Where two persons contract with a third person to undertake a certain liability, and also contract with each other that one of them shall be liable only on the default of the other, the third person not being a party to such contract, the liability of each of such two persons to the third persons under the first contract is not affected by the existence of the second contract, although such third person may have been aware of its existence

Discharge of a Surety:-

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

By Revocation of the Contract of Guarantee.

a) Revocation of continuing guarantee by Notice:-

The continuing guarantee may at any time be revoked by the surety as to further transactions by notice to the creditors.

Once the guarantee is revoked, the surety is not liable for any future transactions however he is liable for all transactions that happened before the notice was given.

b) Revocation of continuing guarantee by surety's death:-

The death of surety operates as a revocation of a continuing guarantee as to the further transactions taking place after the death of surety.

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

c) By Novation:-

The surety under original contract is discharged if a fresh contract is entered into either between the same parties or between the other parties, the consideration being the mutual discharge of the old contract.

By Conduct of the Creditor:-

a) By variance in terms of conduct:-

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.

b) By release or discharge of principal debtor:- (section 134) :-

The surety is discharged if the creditor.

i) enters into a fresh / new contract with principal debtor, by which the principal debtor is released, or

ii) does any act or omission, the legal consequence of which is the discharge of the principal debtor.

c) Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor:-

i) Composition:-

If the creditor makes a composition with the principal debtor, without consulting the surety, the latter is discharged.

ii) Promise to give time:-

When the time for the payment of the guaranteed debt comes, the surety has the right to require the principal debtor to pay off the debt.

iii) Promise not to sue:-

If the creditor under an agreement with the principal debtor promises not to sue him, the surety is discharged.

Cases where surety not discharged.

i) Surety not discharged when agreement made with third person to give time to principal debtor:-

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.

ii) Creditor's forbearance to sue does not discharge surety:-

Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not in the absence of any provision in the guarantee to the contrary, discharge the surety.

d) Discharge of surety by creditor's act or omission impairing surety's eventual remedy (section 139):-

If the creditor does any act which is inconsistent with the rights of the surety or omits to do any act which his duty to the surety requires him to do and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged.

By the invalidation of the contract of guarantee:-

a) Guarantee obtained by misrepresentation:-

Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction.

b) Guarantee obtained by concealment:-

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

c) Guarantee on contract that creditor shall not act on it until co-surety joins:-

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.

Rights of Surety:-

a) Rights of subrogation:-

A guaranteed debt has become due or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor.

The surety steps into the shoes of creditor.

b) Implied promise to indemnify surety:-

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.

Right against the creditor:-

a) surety's right to benefit of creditor's securities:-

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.

Right to set off:-

If the creditor sues the surety, for payment of the principal debtor's liability, the surety may have the benefit of the set off, if any, that the principal debtor had against the creditor.

c) Right to share reduction:-

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

Rights against co-securities:-

a) Co-securities liable to contribute equally:-

Each co-surety is liable to contribute equally for discharge of whole debt or the part of the debt remains unpaid by debtor.

b) liability of co-securities bound in different sums:-

The principal of equal contribution is however, subject to the maximum limit fixed by a surety to his liability. Co-securities who are bound in different sums are liable to pay equally as far as the limits of their respective obligations.