

### 3.1 Contracts of Indemnity and Guarantee

The contract of Indemnity and contract of Guarantee are specific types of contract.

The specific provisions relating to these contracts are contained in sections 124 to 147 of the Indian Contract Act, 1872.

#### 3.2 Contract of Indemnity

Meaning:-

A contract by which one party promises to save the other party 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.

The person who promises to make good the loss of other person is called the Indemnifier (promisor). The person whose loss is to be made good is called Indemnity holder (Promisee)

Example:- A contract to Indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of Rs 2000. This is a contract of indemnity. Here A is the indemnifier and B is the indemnity holder.

### 3.3 Essentials of a Contract of Indemnity

- a) The contract of Indemnity must satisfy all the requirements of a valid contract.
- b) There must be a promise to compensate the other party for the loss suffered by that party.
- c) The loss may be due to the conduct of the promisor himself or any other person.
- d) The contract of indemnity must be express.

### 3.4 Mode of Contract of Indemnity

- i) A contract of indemnity is said to be express when a person expressly promises to compensate the other from loss.
- ii) A contract of indemnity is said to be implied when it is to be inferred from the conduct of the parties or from the circumstances of the case.

### 3.5 Rights of Indemnity Holders:

Section 125, deals with the rights of the indemnity holder when sued by the indemnifier.

#### 1. Right to recover damages:

The indemnity holder has the right to recover all damages which he might have compelled to pay in any suit in respect of a matter covered by the contract.

#### 2. Right to recover costs:

The indemnity holder is entitled to recover all costs incurred by him in filing or defending suits relating to the contract.

#### 3. Right to recover amounts paid under compromise.

The indemnity holder is entitled to recover from the indemnifier all sums which he has paid under any compromises of any such suit.

#### 4. Right to sue for specific performance

Indemnity holder is entitled to sue for specific performance of the contract if he has incurred absolute liability.

### 3.6 Contract of Guarantee:-

As per section 126 of the Contract Act, "A contract of guarantee is a contract to perform the promise or discharge the liability of a third person in case of his default".

Three parties are involved in a contract of guarantees.

#### a) The Guarantor or Surety

The guarantor is a person who gives the guarantee for the performance of the promise or the discharge of the debt of a third person in case of his default.

#### b) The Principal debtor

The principal debtor is the person in respect of whose default the guarantee is given.

#### c) The Creditor

The creditor is the person to whom the guarantee is given.

Example:- A lends Rs 5000 to B, and C promises to A that if B does not pay the money, C will repay it to A, there is a contract

of guarantee. In this example, B is the principal debtor, A is the creditor and C is the guarantor or surety.

### 3.7 Features of a Contract of Guarantee

#### a) Essentials of a valid contract

In a contract of guarantee, there must be a primary liable in some person other than surety. If that liability does not exist there can not be a contract of guarantee.

Example:-

A, the debtor owes a debt to B, the creditor. C gives a guarantee to B for the payment of the debt after it is barred by the law of limitation. C pays the amount to B. C can not recover the amount from A as there is no enforceable liability against A.

#### b) Some one must be primarily liable

In a contract of guarantee, the principal debtor is primarily liable under the contract. If the liability does not exist, there is no valid contract of guarantee.

c) The liability of surety is conditional

The liability of surety is collateral or secondary. The liability of surety arises only when the principal debtor makes a default.

d) Guarantee contract should not necessarily be in writing:-

A contract of guarantee may be oral or written. But in England, a guarantee must be in writing and signed by the party to be charged.

e) Consent of all the three parties

The principal debtor should request the guarantor to act as a surety. The guarantor should be willing to act as a surety. The creditor should be willing to accept the surety.

f) Number of contracts

\* a primary contract between the creditor and the principal debtor.

\* a secondary contract between the creditor and the guarantor

\* a third contract between the guarantor and the principal debtor

### 3.8 Differences between a contract of Guarantee and a contract of Indemnity

#### Contract of Guarantee

- 1) The surety's liability is secondary
- 2) There are three contracts in a contract of guarantee
- 3) There are three parties to the contract
- 4) The surety has no other interest in the transaction apart from his guarantee
- 5) A surety can proceed against the principal debtor in his own right
- 6) The liability of the guarantor is dependent on the liability of the principal debtor
- 7) The liability has been undertaken by the promisor at the request of the debtor

#### Contract of Indemnity

- 1) The person who gives an indemnity is primarily liable
- 2) There is a single contract
- 3) There are two parties to the contract
- 4) The indemnifier has some other interest in the contract
- 5) An indemnifier cannot sue a third party for loss in his own name
- 6) The liability of the promisor is independent of the liability of any other party
- 7) The liability has been undertaken by the promisor without the request of the debtor.

### 3.9 kinds of Guarantee

Case Law: Bachevaiser Vs Lewis

From the point of view of formation, a contract of guarantee may be,

a) Express

Express contract of guarantee is one which is expressed by words or spoken or written.

b) Implied

A contract of guarantee is said to be implied, when it is inferred from the conduct of the parties.

On the basis of purpose, a contract of guarantee may be classified into three groups.

a) Retrospective Guarantee

A guarantee given for an existing debt or obligation is known as a retrospective guarantee

b) Prospective Guarantee

A guarantee given for a future debt or obligation is known as a prospective guarantee

c) Fidelity guarantee

A guarantee which is given for the good conduct or honesty of a person is known as fidelity guarantee.

On the basis of number of transactions, a contract of guarantee may be classified into two groups.

a) Specific Guarantee :-

When a guarantee extends to a single transaction or debt, it is called a specific guarantee. It is also known as a simple guarantee. The guarantor will not be liable for any fresh transaction that has been taken place between the principal debtor and creditor after the performance or discharge of the first transaction or debt.

b) Continuing Guarantee :-

When a guarantee extends to a series of transaction, it is called a continuing guarantee. According to section 129 of the Indian ~~Contract~~ Contract Act, when a guarantee extends to a series of distinct or separate transactions between the creditor and the principal debtor of time

it is called a continuing guarantee or  
a running guarantee

Example:- At A's request, B employed  
C for collecting the rent of B's  
Zamindari. A promised 'B' to be  
responsible up to Rs 10,000 for the  
collection and payment by C of those  
rent. This is a continuing guarantee.

#### 10 Difference between a Specific Guarantee and a continuing Guarantee

##### Specific Guarantee

- i) It applies to a particular on a single debt between the creditor and the principal debtor
- ii) It cannot be revoked by the guarantor until the debt is repaid
- iii) From the point of view of security specific guarantee is not better

##### Continuing Guarantee

- i) It applies to a series of debts between the creditor and the principal debtor.
- ii) It can be revoked by the guarantor at any time in respect of future transaction by giving a notice to the creditor.
- iii) It is better than a specific guarantee.

### 3.11 Revocation:

A continuing guarantee comes to an end only when guarantee revoked.

#### i) By Notice (section 130):

A continuing guarantee can be revoked only in respect of future transactions. It can be revoked at any time by giving notice to the creditor.

#### ii) By Death (section 131):

A continuing guarantee is revoked on the death of the guarantor with regard to future transactions. When the consideration for the guarantee is indivisible it cannot be revoked even the death of the surety.

#### iii) By Variance of Contract:

A surety is liable for what he has ~~taken~~ undertaken in the contract. He will be discharged from his liability if without his consent, the terms of the original contract have been altered in any way.

iv) By acts of the Creditor:  
If the creditor does anything which is inconsistent with the rights of the surety against the principal debtor, then the continuing guarantee gets terminated.

v) By Novation:

Novation means substitution of a new contract of guarantee for an old one. In such cases, the original contract comes to an end.

vi) By Release of securities:

The surety is discharged if the creditors loses or parts with securities belonging to principal debtor, without the consent of the surety.

viii) By other modes

A continuing guarantee is also revoked when the surety's liability is discharged.

### 3.12. Rights of Surety.

The surety has certain rights against the principal debtor, the creditor and his co-sureties.

#### A] Right against the principal debtor-

##### a) Rights to be subrogated

After discharging the liability of the principal debtor, the surety is clothed with the rights of the creditor. The surety steps into the shoes of the creditor. These rights can be exercised against the principal debtor. This right of the surety is called "right to be subrogated".

##### b) Rights for Securities

The surety is entitled to all securities which the creditor has against the principal debtor. A surety cannot claim a part of the securities of the principal debtor in the hands of the creditor merely because he has paid part of the debt.

### c) Rights to be indemnified

Indemnity means compensation

There is an implied promise by the principal debtor to indemnify the surety. The principal debtor promises to indemnify the surety to pay all sums which the surety has rightfully paid to the creditor.

### d) Right to relief

The surety can compel the principal debtor to relieve him from the liability by paying off the debt.

### e) Right to issue notice to the debtor

The surety has the right to issue a third party notice to the principal debtor when sued by the creditor.

### f) Right to equities:

On the payment of the guaranteed debt to the creditor, the surety is entitled to all the equities which the creditor could have enjoyed not only against the principal but also against any other person claiming through him.

## B] ~~Rights~~ Rights against the Creditor

- a) Right before the payment of the guaranteed debt

A surety may require the creditor to sue the principal debtor after the guaranteed debt has become due. The surety will be responsible to compensate the creditor for any expense or loss resulting therefrom.

- b) Right to set off

The surety when sued, can claim set off or counter claim, which the principal debtor would have claimed against the creditor.

- c) Right to request the creditor to sue the debtor first.

After the guaranteed debt becomes due, the surety can request the creditor to sue the debtor first. The surety has to indemnify the creditor for all losses resulting therefrom. But a surety cannot compel the creditor to sue.

the principal debtor first before suing him.

d) Right to demand for the termination of services.

In the case of fidelity guarantee, the surety can demand the employer to terminate the services of the employee has been proved dishonesty

e) Right to claim

The surety has the right to claim securities from the creditor when the debt has been repaid by the debtor.

f) Right to equities

On the payment of the guaranteed debt to the creditor, the surety is entitled to all the equities which the creditor could have enjoyed not only against the principal but also against any other person claiming through him.

### C] Rights against Sureties:-

When a debt is guaranteed by two or more sureties, they are called as co-sureties.

#### a) Equal Shares:

Co-sureties are liable to contribute equally when there is a single debt. If any one of them is compelled to pay the whole debt, he can claim contribution from other co-sureties. A surety has a right to claim contribution from the other co-surety or co-sureties.

#### b) Different Shares:

Where the co-sureties are bound in different sums with reference to the same debt, they are liable to pay equally in Indian law. But in English law they are liable to pay proportionately.

c) Right to the benefits of securities held by any of the co-sureties.

All the co-sureties are entitled to the benefits of the securities the principal debtor held by any of them, whether they are aware of existence of such securities or not.

### 3.13 Nature and Extent of Surety's liability

Sec 128 of Indian Contract Act states the extent or quantum of surety's liability

a) Surety's liability is Secondary

In a contract of guarantee, the primary liability is that of the principal debtor. The surety's liability arises only when the principal debtor makes default in repayment of the debt. Therefore, the surety's liability is secondary.

b) Surety's liability is co-extensive

The extent of surety's liability is co-extensive with that of the principal in the absence of any specific agreement. The surety is liable to the creditor to the same extent to which the principal debtor is liable.

c) Surety's liability when original contract is void or voidable

The liability of the surety is not simultaneous with that of the principal debtor. The contract between the surety and the creditor is an independent contract and not a collateral one. When the original contract is between the creditor and the debtor becomes void, the surety will remain liable and his liability will be primary.

### 3.14 Discharge of Surety from liability

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

a) By Revocation

i) Revocation by notice:

A specific guarantee cannot be revoked by the surety if the liability has already

accured. A continuing guarantee may at any time be revoked by the surety by notice to the creditor for future transactions by notice to creditor.

### ii) Revocation by Death of Surety

The death of the surety operates as a revocation of a continuing guarantee. The deceased surety's estate will not be liable for any transactions entered into between the creditor and the principal debtor after the death of the surety.

### iii) Revocation by Novation

Novation means substitution of a new contract of guarantee for a old one either between the same parties or between the old as well as new parties

### b) By the conduct of the creditor

- i) Variance in terms of contract
- ii) Release or discharge of the principal debtor
- iii) Compounding by creditor with the principal debtor
- iv) Impairing surety's remedy
- v) Loss of security

## ⇒ By Invalidation of Contract

If the contract of guarantee is invalid, the surety will also not be liable under the contract.

### ⇒ A guarantee is obtained

- \* by fraud
- \* by concealment of facts
- \* Without any consideration
- \* Upon the contract that a co-surety will also join him, but he does not join
- \* Lack of any other essential element of contract.