

Corporate Laws

BBA(FIA)

Lecture 13

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Contracts of Indemnity and Guarantee

Definition of Indemnity



Section 124 of the Act defines a contract of Indemnity:

“A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor by self, or by the conduct of any other person, is called a contract of indemnity”.

A contract of Indemnity is an example of contingent contract.

The person who promises to make good the loss is called ‘indemnifier’ (promisor)

The person whose loss is to be made good is called ‘indemnified’ or ‘indemnity holder’ (promisee)



(A's) friend (C), contracted to indemnify (A) against the consequences of any proceedings which (B) may take against (A). It is a contract of indemnity. If under the proceedings, (A) is ordered to pay the amount to (B), then (A) can recover the same from (C).

- [illegible]

Example



Mr. A after having lost the share certificate of a certain company, applies to the company for the issue of a duplicate share certificate. The company asks A to furnish an indemnity bond in its favour to save it from loss that may be caused to it if any claim is made by any person on the original certificate. A executes the indemnity bond. Indemnity bond is a contract between the indemnifier and indemnity holder (company).

(Indemnifier) A \longrightarrow Company (Indemnity holder)

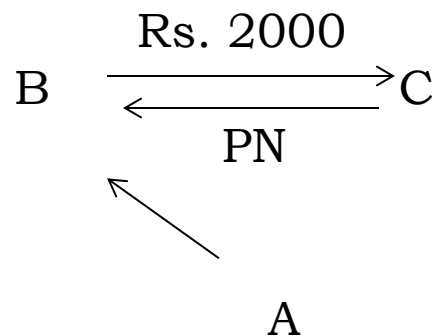
Example



(B) owed Rs. 2000 to (C) on a Promissory Note. On the date of payment (C) could not return the PN (lost) to (B). (A) assured (B) that no suit will be filed later by (C) in respect of the sum and requested (B) to make the payment without insisting on getting back the PN and promised to indemnify (B) against the consequences of any suit which (C) may file against (B) in that regard. As a result (B) makes the payment.

It is the contract of indemnity between A and (B). If (A) did all this of his own, without any request from (C).

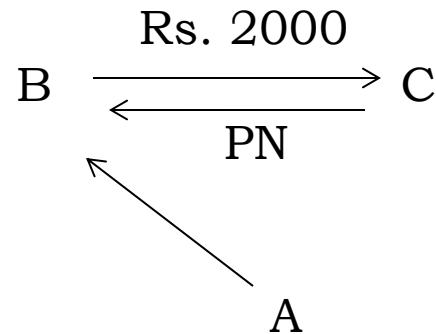
Later on (C) filed a suit against (B) in respect of the sum and (B) was ordered to pay to (C) Rs. 2000 plus the costs of the suit. (A) shall be required to pay (B) the total amount under the contract of indemnity.



Example



((B)'s paying to (C) as per the desire of (A) is the consideration moving from (B)'s side for (A) and (A)'s promise to indemnify (B) is the consideration moving from A's side for (B).



Essentials of A Contract of Indemnity



1. There must be two parties:
Indemnifier (promisor) and Indemnified (promisee).
2. There must be a promise to save the other from loss. The promise may be express or implied.
3. The loss may be caused by the conduct of the promisor by self or by any other person.
4. No request from such third person. If indemnifier promises at the request of the third person, it would be a case of contract of guarantee.
5. All the essentials of a contract must be present in the contract of indemnity.

Rights of Indemnity-holder when Sued



According to sec. 125, the indemnity holder is entitled to recover from the promisor (indemnifier):

- 1.All damages** which may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies.
- 2.All costs** reasonably incurred, in bringing or defending suit, provided acted prudently or with the authority of the indemnifier.
- 3.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 indemnifier and was prudent or was authorised by the indemnifier.

Contract of Guarantee



Sec 126:

“A contract of guarantee is a contract to perform the promise, or to discharge the liability, of a third person in case of his default”.



Purpose: A Contract of guarantee is made to enable a person to get a loan or goods on credit or employment.

Parties to the Contract



A Contract of guarantee has 3 parties:

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

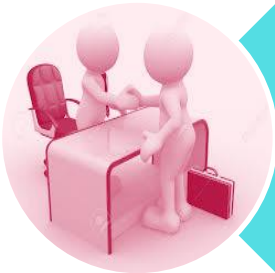
Surety gives guarantee to creditor for Principal debtor.



Three Contracts are Formed



Between the Creditor and Principal Debtor



Between Surety and Creditor



Between Principal Debtor and Surety

Case Discussion



Case: Swann vs. Bank of Scotland

Facts of the Case:

A bank allowed an overdraft to a customer C on the guarantee of G. The grant of such overdraft was contrary to a law and as such was void i.e., not recoverable. C defaulted in returning the amount. The bank sued surety G.

Decision:

It was held that G was not liable since nothing was due from the debtor.

Nature & Extent of Surety's Liability



1. Surety's liability is co-extensive with that of the principal debtor unless it is otherwise provided in the contract. (sec. 128)
2. Surety's liability is secondary & not primary: insolvency of surety
3. Default by debtor amounts to default by the surety.
4. Creditor is not bound to exhaust the remedies against principal debtor before suing the surety.
5. Creditor need not first resort to securities before suing the surety.
6. Surety is not liable for guarantee if caused by misrepresentation or fraud.
7. Surety's obligation towards the creditor is independent of the debtor's obligation: insolvency of debtor, variation in contract.

Essential Features of a Contract of Guarantee



It must fulfill all essentials of a valid contract.

1. There must be consideration for the promise of guarantee.
2. The parties must be competent to contract.
3. Free consent.
4. Must be legally enforceable: liability existing or future. Time barred debt is not good.
5. A contract of guarantee may be oral or in writing.
6. Concurrence of all the three parties.

Consideration for Guarantee



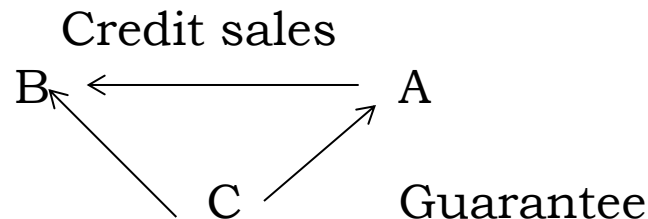
- There need be no direct consideration between the surety and creditor.
- Consideration received by the principal debtor is sufficient for the surety.
- Sec 127 expressly provides to this effect and states that “**anything done, or any promise made for the benefit of the principal debtor, may be a sufficient consideration to the surety for giving the guarantee.**”

Consideration for Guarantee

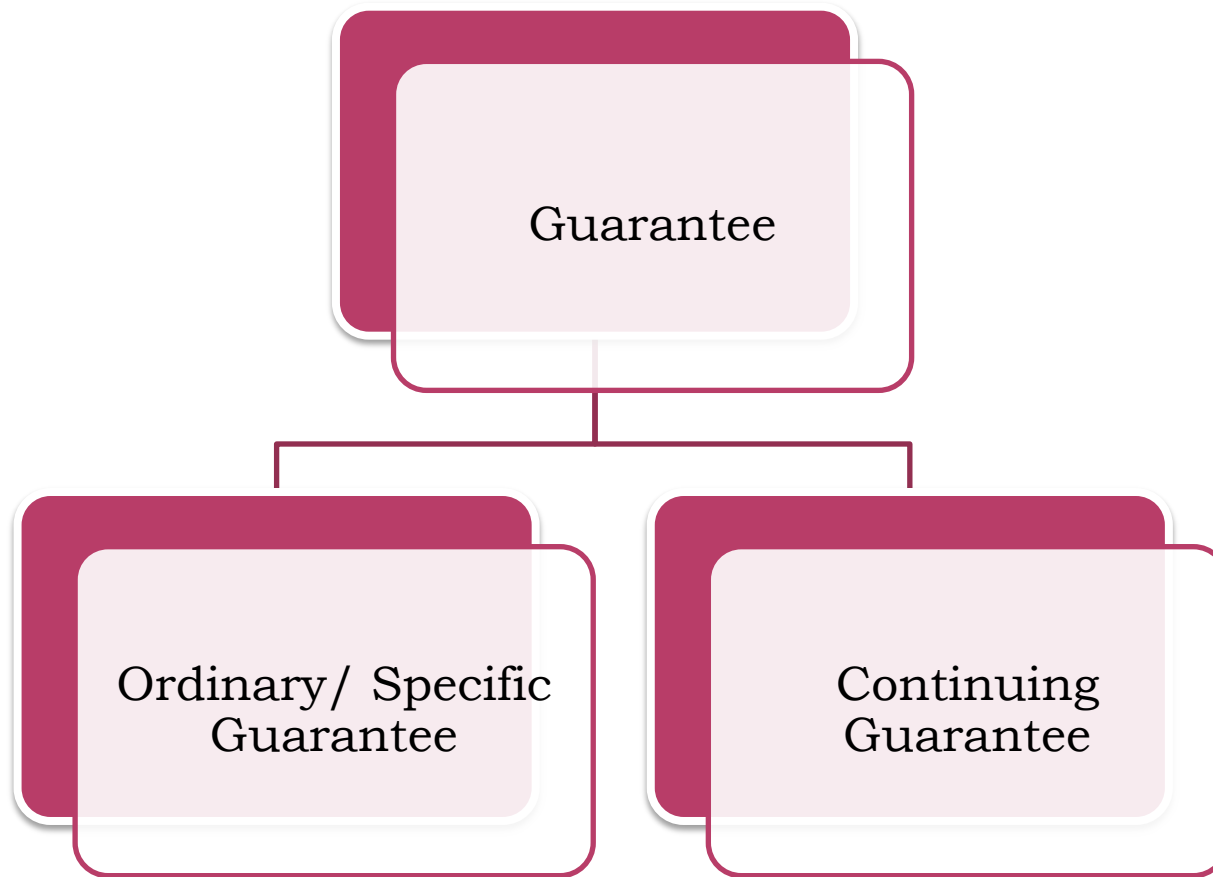


A guarantee for past debt would be invalid as it lacks consideration. Fresh consideration must move.

(B) requests (A) to sell and deliver to her goods on credit. (A) agrees to do so, provided (C) will guarantee the payment of the price of the goods. (C) promises to guarantee the payment in consideration of (A)'s promise to deliver the goods.



Kinds of Guarantee



Ordinary / Specific Guarantee



- A guarantee given for only one specific transaction between the debtor & the creditor is called a Specific Guarantee.
- It is intended to come to an end with the completion of the transaction.



Continuing Guarantee



A guarantee which extends to a series of transaction, is called a 'continuing guarantee'. (Sec. 129)

1. Is valid up to the guarantee time limit.
2. Not exhausted by the first advance or credit upto the guarantee limit.
3. Nature depends upon the intention of parties or the circumstances.
4. Guarantee given for entire consideration is not a continuing guarantee.

In a continuing guarantee, the surety may put any limits on the quantum of his / her liability. The liability will be determined accordingly.

Discharge of Surety from Liability



1. Notice of revocation
2. Death of surety
3. By variance in terms of contract
4. Release or discharge of principal debtor
5. Arrangement by creditor with principal debtor without surety's consent: not to sue, extra time
6. Creditors act or omission impairing surety's eventual remedy
7. By loss of security
8. By invalidation of guarantee: lacks essentials of valid contract



THANK YOU