



# Contract of Indemnity & Guarantee

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# 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 himself, or by the conduct of any other person, is called a 'contract of indemnity. [section 124].*
- For Example - A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of 200 rupees. This is a contract of indemnity.

## Section 124 - “Contract of indemnity” defined

- Promise by the indemnifier to the indemnity holder
- Purpose of promise – To save the indemnity holder from loss caused to him
- Such loss may be caused by the conduct of the indemnifier or of any other person



- **PARTIES TO CONTRACT OF INDEMNITY:**

- **INDEMNIFIER:** The person who promises to indemnify.
- **INDEMNITY HOLDER:** The person whose loss is to be indemnified.

- **Examples:**

- Motor insurance
- Marine insurance
- Fire insurance

- **Life insurance is not the contract of indemnity.**

# ESSENTIALS OF CONTRACT OF INDEMNITY

1. Essentials of a valid contract.
2. Indemnifier promises to save indemnity holder from the loss caused to him by the conduct of the promisor , or by the conduct of any other person.
3. Contract may be expressed or implied.
4. Liability of indemnifier commences when the indemnifier suffers some loss according to the terms and conditions of the contract.
5. Contracts of insurance are also covered in this.

# Essentials of a contract of indemnity

- **It must be a valid contract under section 10 of Indian Contract Act:**
  - Free consent
  - parties competent to contract
  - lawful consideration, lawful object
  - not expressly declared void
- **Two parties:**
  - Indemnifier (Promisor)
  - Indemnity holder (Promisee)
- **Loss to indemnity holder:**
  - Occurrence of loss or damage is a contingency upon which liability of the indemnifier comes into existence.

# RIGHTS OF INDEMNITY-HOLDER WHEN SUED



The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor-

- (1) all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;
- (2) 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 authorized him to bring or defend the suit;
- (3) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contract 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 authorized him to compromise the suit.

# Section 125 - Rights of indemnity- holder when sued

## **Preconditions:**

- Existence of a contract of indemnity
- Indemnity holder should have acted within the scope of his authority

Indemnity holder entitled to recover from the indemnifier –

- **Damages**
- **All costs**

Provided:

- Indemnity holder did not contravene the orders of the indemnifier
- Indemnity holder acted prudently; or
- Indemnifier authorized indemnifier to bring/defend the suit

- **Any compromise payment**

Provided:

- compromise is not contrary to the orders of the indemnifier
- Indemnity holder acted prudently
- Indemnifier authorized indemnity holder to compromise the suit



# Rights of indemnifier



- Rights under doctrine of subrogation.
- To sue against third party after indemnifying the indemnity holder.
- Not to compensate for losses not covered under con. Of indemnity.

# Implied contract of indemnity

## Legal and equitable duty to indemnify

Implied indemnity arises where the relation between the parties is such that either in law or in equity there is an obligation upon one party to indemnify the other.

- **As expounded by Lord Halsbury in Sheffield Corporation v. Barclay 1905 AC 392**

*“It is a general principle of law when an Act is done by one person at the request of another which Act is not in itself manifestly tortuous to the knowledge of the person doing it, and such Act turns out to be injurious to the rights of a third party, the person doing it is entitled to an indemnity from him who requested that it should be done.”*

- **Chitty on Contracts, 22nd Edn., Vol. II, in Para, 1035, at p. 445**

*“In many cases the law implies a promise to indemnify. If the circumstances are such that the law imposes on any person a legal or equitable duty to indemnify, it will imply, a promise on his part to do that which under the circumstances he ought to do.”*

# Commencement of Indemnifier's liability: Judicial Interpretation



- **Earlier view based on English Common Law:**
  - No action can be maintained against the indemnifier till the indemnity holder has suffered actual loss.
- **Present view based on equitable principles:**
  - Existence of a clear enforceable claim suffices to call the indemnifier's obligation into action. The indemnity holder can compel the indemnifier to place him in a position to meet the liability that may be cast upon him without waiting until he has actually discharged it.

# Contracts of guarantee



- A “contract of guarantee” is a contract to perform the promise, or discharge the liability, of a third person in case of his default. A guarantee may be either oral or written. [section 126].
- **PARTIES TO CONTRACT OF GUARANTEE**
  - **SURETY:** The person who gives the guarantee is called the “surety”. Person giving guarantee is also called as ‘guarantor’ . ;
  - **PRINCIPAL DEBTOR:** the person in respect of whose default the guarantee is given is called the “principal debtor”, and
  - **CREDITOR:** the person to whom the guarantee is given is called the “creditor”.
- Three parties are involved in contract of guarantee. Contract between any two of them is not a ‘contract of guarantee’. It may be contract of indemnity.
- Primary liability is of the principal debtor. Liability of surety is secondary and arises when Principal Debtor fails to fulfill his commitments. However, this is so when surety gives guarantee at the request of principal debtor. If the surety gives guarantee on his own, then it will be contract of indemnity. In such case, surety has all primary liabilities.

# ESSENTIALS OF CONTRACT OF GUARANTEE:

- THREE PARTIES.
- THREE CONTRACTS.
- SECONDARY LIABILITY OF SURETY.
- EXISTENCE OF PRINCIPAL DEBT—ENFORCEABILITY BY LAW.
- CONSIDERATION-NO NEED FOR SEPARATE CONSIDERATION.
- NO MISREPRESENTATION OR CONCEALMENT.
- CONTRACTUAL CAPACITY OF PARTIES.
- CONTRACT OF GUARANTEE MUST CONTAIN ALL THE ESSENTIAL ELEMENTS OF VALID CONTRACT.
- CONTRACT OF GUARANTEE IS A COMPLETE AND SEPARATE CONTRACT BY ITSELF.

# KINDS OF GUARANTEE



- **1.) ABSOLUTE GUARANTEE** (Unconditional guarantee by surety)
- **2.) CONDITIONAL GUARANTEE** (Enforceable when contingency along with default happens)
- **3.) RETROSPECTIVE GUARANTEE** (Given for existing debt)
- **4.) PROSPECTIVE GUARANTEE** (Given for future debt)
- **5.) LIMITED GUARANTEE** (For a single transaction)
- **6.) UNLIMITED GUARANTEE** (Unlimited as to time or amount)
- **7.) GENERAL GUARANTEE** (For acceptance by the public generally)
- **8.) SPECIAL GUARANTEE** (For acceptance by the particular person)
- **9.) CONTINUING GUARANTEE** (Extends to series of transactions)

## CONSIDERATION FOR GUARANTEE. (Section 127)

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.

### ➤ **Illustration**

B requests A to sell and deliver to him 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. This is a sufficient consideration for C's promise.

### ● **SURETY'S LIABILITY. (Section 128)**

The liability of the surety is coextensive with that of the principal debtor, unless it is otherwise provided by the contract.

### ➤ **Illustration**

A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

# Nature & extent of surety's liability.



- In general circumstances the liability of surety arises only in case of default of principal debtor so his liability is secondary.
- the liability of surety is co-extensive with that of principal debtor—if liability of surety reduces then surety's liability also reduces.—when creditor recovers a part of his loan from property of principal debtor.
- when liability of principal debtor reduces by order of court.
- If due to some reasons the principal debtor cannot be held liable , still surety can be held liable in following situations—
- If principal debtor is a minor
- If principal debtor is declared insolvent.
- If liability of principal debtor has become time-barred.
- If creditor delays in filing suit against the debtor.
- -moreover, in certain cases a surety can restrict or limit his liability if he wants to do so.he can also restrict the amt. of liability.



# RIGHTS OF SURETY



- AGAINST THE PRINCIPAL DEBTOR

- Right of subrogation
- Right to indemnity

- AGAINST THE CREDITOR

- Surety's right to benefit of creditor's securities 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).
- Surety can rely upon any set off or counter claim which the debtor must possess against the creditor.

- AGAINST THE CO-SURETIES

- When several co-sureties have given guarantee for the same debt with their maximum limits, they are liable to pay equally but subject to the limits they have fixed.

# DISCHARGE OF SURETY



- Revocation by notice.
- Revocation by death.
- Discharge of surety by variance in terms of contract.
- Discharge of surety by release or discharge of principal debtor.
- Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor.
- Creditor's forbearance to sue does not discharge surety.
- Release of one co-surety does not discharge other.
- Discharge of surety by creditor's act or omission impairing surety's eventual remedy.
- By the creditor losing his security.
- By concealment or misrepresentation.

# Distinguish between Contract of Indemnity and Contract of Guarantee.

BASIS	CONTRACT OF INDEMNITY	CONTRACT OF GUARANTEE
<b>1. No. of parties</b>	There are two parties to the contract viz. indemnifier (promisor) and the Indemnified (promise).	There are three parties to the viz. creditor, principal debtor and the surety
<b>2. Liability of parties</b>	Liability of the indemnifier to the indemnified is primary and independent.	Liability of the surety to the creditor is collateral or secondary, the primary liability being that of the principal debtor.
<b>3. No. of contracts</b>	There is only one contract in case of a contract of indemnity, i.e., between the indemnifier and the indemnified.	In a contract of guarantee there are three contracts, between principal Debtor and Creditor; between creditor and the surety and between surety and principal debtor.
<b>4. Liability is due</b>	The liability of the indemnifier arises only on the happening of a contingency.	There is usually an existing debt or duty, the performance of which is guaranteed by the surety.
<b>5. Liability of third party</b>	An indemnifier cannot sue a third party for loss in his own name, because there is no privity of contract. He can do so only if there is an assignment in his favour.	A surety, on discharging the debt due by the principal debtor, steps into the shoes of the creditor. He can proceed against the principal debtor in his own right