

CONTRACT OF INDEMNITY AND GUARANTEE

INTRODUCTION

The term indemnity means to make good the loss to compensate the party who has suffered some loss.

DEFINITION

Sec.124 of the Indian contract act defines a contract of indemnity thus, 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". The person who promises to make good the loss is called the indemnifier. The person whose loss is to be made good is called the 'indemnity holder'

ESSENTIALS OF A VALID CONTRACT OF INDEMNITY

1. The contract of indemnity must contain all the essentials of valid contract.
2. It is contract between two parties one person promises to save the other from any loss, which he may suffer.
3. The loss may be caused by the conduct of the promisor himself or any other person.
4. The contract of indemnity may be express or implied.

RIGHTS OF INDEMNITY HOLDER

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 bringing or defending such suit, if, 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 contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make the absence of any contract of indemnity or if the promisor authorized him to compromise the suit.

RIGHTS OF INDEMNIFIER

The act makes no mention of the rights of indemnifier. It has been held, however that his rights of a surety, under Sec. 141 of the Indian contract Act. That is the rights of the promisor are virtually the same as those of the surety in a contract of guarantee.

TIME OF COMMENCEMENT OF THE INDEMNIFIER LIABILITY:

The Indian contract act 1872 is silent on the time of commencement of liability of indemnifier. On the basis judicial pronouncement of courts, it can be said that the liability Of an indemnifier commences as soon as the liability of the indemnity holder becomes absolute and certain.

CONTRACT OF GUARANTEE

According to sec 126, "A contract of guarantee is a contract to perform the promise or discharge the liability of third person in case of his default". A guarantee may be either oral or written

Parties to a contract of guarantee

Creditor: The person to whom the guarantee is given is called the creditor.

Surety: The person who gives the guarantee is called the surety.

Principal debtor: The person for whom the guarantee is given is called the principal debtor In a contract of guarantee there are three separate agreements.

- One between the principal debtor and creditor
- The second between the creditor and the surety
- The third between the surety and the principal debtor

ESSENTIALS OF A CONTRACT OF GUARANTEE

following are the essential features of a valid contract of guarantee.

1. Tripartite agreement:

contract of guarantee is a tripartite agreement between the principal debtor, creditor and surety

2. Consent of three parties:

There must be consent of all three parties

3. It may be oral or in writing:

A contract of guarantee may be either oral or in writing. Whereas, as per English law, the guarantee must be in writing and signed by the party who offers guarantee.

4. Existence of Liability:

There must be an existing liability or a promise whose performance is guaranteed and such liability must be enforceable by law. The exception to this rule is a guarantee given for minor's debt. Though minor's debt is not enforceable by law, yet the guarantee given for minor's debt is valid.

5. Essentials of a valid contract:

All the essential of a valid contract must be present in a contract of guarantee. However the following points are worth noting in this regard.

A) The principal debtor need not be competent to contract and the surety would regarded as the principal debtor and would be personally liable to pay.

B) Surety need not be benefited. 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.

6. Guarantee not to be obtained by misrepresentation:

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

7. The contract of guarantee must be supported by consideration

We have discussed above that n contract of guarantee must have all the essential, valid contract. It will be interesting to know that it is not necessary that there be direct consideration between the surety and creditor. The law presumes that consideration received by the principal debtor is the sufficient consideration for the surety.

8. The promise to pay must be conditional

It is another important essential element of a contract of guarantee. There must be a conditional promise to be liable on the default of the principal debtor.

9. There should be no concealment of fact

The creditor should disclose to the surety the facts which are likely to affect the surety's liability. The guarantee obtained by the concealment of such facts is invalid.

DISTINCTION BETWEEN CONTRACT OF INDEMNITY AND CONTRACT OF GUARANTEE

	Contract of indemnity	Contract of guarantee
1	There are two parties - the indemnifier and the indemnity holder	There are three parties - the creditor, principal debtor and the surety
2	The liability of the indemnifier is primary	The liability of the primary debtor is primary. The liability of surety is secondary. That is the surety is liable only if principal debtor fails.
3	There is only one contract	There are three contracts
4	Indemnifier need not act on the request of indemnified	Surety gives guarantee on the request of principal debtor
5	The liability of indemnifier arise on the happening of a contingent event	There is an existing debt or duty , the performance of which is guaranteed by the surety
6	An indemnifier cannot sue a third party for loss in his own name because there is no privity of contract	A surety on discharging the debt due by the principal debtor, can take action against the principal debtor for his own recovery
7	It is for reimbursement of loss	It is for the security of the creditor for ensuring its payment
8	The promiser has some interest in the transaction, apart from indemnity	The surety gets nothing substantial for his promise

KINDS OF GUARANTEE

Types of contract of guarantee are

1) Simple or specific guarantee

It is one in which guarantee is given for a single specific debt (or) transaction. It comes to an end as soon as the liability under that transaction ends. A specific guarantee once given is irrevocable.

2) Continuing guarantee

A guarantee which extends to a series of transactions is called a continuing guarantee. A surety's liability continues until the revocation of the guarantee.

A continuing guarantee may be given for a part of the entire debt or for the entire debt subject to a limit.

Revocation of continuing guarantee

1. By nature of revocation (Sec. 130)
2. By death of surety
3. By modes of discharging the surety:

A continuing guarantee is also revoked in the same manner in which the surety is discharged as under

- ❖ Novation
- ❖ Variance in terms of contract
- ❖ Release or discharge of principal debtor
- ❖ When the creditors enter into an arrangement with the principal debtor
- ❖ Creditor's act or omission impairing the surety's eventual remedy
- ❖ Loss of security

3. Guarantee for performance of a promise:

When a person enters in to with another to do something but the promise gets doubt about the capacity of promisor to perform, he can ask him to bring a guarantor. In such cases the surety becomes liable to do the work if the principal debtor fails. It is called "Guarantee for performance of a promise"

4. Guarantee for discharge of liability:

When a person lends a loan to another but gets doubt about the intention of the borrower to repay the debt in time, he can ask for a surety. In such cases the surety should repay the loan amount

with interest if the principal debtor fails. It is called a guarantee for discharge of a liability.

5. Guarantee for honesty of employee:

Sometimes an employer may get a doubt about the employee he had employed as to his honesty and take a guarantor. Such surety becomes liable to compensate the employer for any loss or damage caused by the employee on account of his dishonesty. It is called a fidelity guarantee.

6. Prospective guarantee:

The guarantee given for a present transaction is called a prospective guarantee. Generally all guarantees will be prospective.

7. Retrospective guarantee:

A guarantee given in respect of a past transaction is called retrospective guarantee. Such guarantees are taken when the original surety dies or becomes insane or insolvent.

RIGHTS OF SURETY

A. Rights of surety against the creditor

1.Right to benefit of creditor's securities:

The surety is entitled to all the securities which the creditor was holding at the time of contract of guarantee. The surety can claim the securities from the creditor on the discharge of full liability of the principal debtor which has been guaranteed by the surety. The surety however is not entitled to the benefit of any security subsequently given.

2.Right of subrogation

Where a guaranteed debt has become due on 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. Such a right of surety which the law vests in him is known as right of subrogation.

3.Right to file Quia timet Action

The surety has a right at any time after the guaranteed debt has become due and before he is called upon to pay, to require the creditor to sue for and recover the guaranteed debt. This is called the right to quia timet action. However he must undertake to indemnify the creditor for the risk, delay expenses which he may by so doing.

4.Rights in case of fidelity guarantee

In the case of fidelity guarantee like guarantee of conduct, honesty etc. of the principal debtor, the surety can call upon the creditors or the employer to dismiss the employee whose honesty he has

guaranteed in the event of proved dishonesty of the servant and thus further loss can be avoided.

5.Right to set-off

The surety is also entitled to the benefit of any set-off or counter claim, which the primary debtor might possess against the creditor in respect of the same transaction.

B. Right against the principal debtor

1.Right of subrogation

The surety is subrogated to all rights which the creditor had against the principal debtor. When the surety has paid the guaranteed debt on the default of the principal debtor the surety steps into the shoes of the creditor and will be able to exercise against the principal debtor all these rights and remedies which could be exercised by the creditor

2.Right to indemnity

According to Sec. 145, "in every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety and the surety is entitled to recover from the principal debtor whatever the sum he has rightfully paid under the guarantee, but no more than which he has paid wrongfully. The right occurs only on payment of all that the surety is liable under the guarantee. The following two points must also be noted in connection with this right to indemnity

(a) . The surety cannot claim more than what he has actually paid to the creditor. Thus if he discharges the debt by compromise at less than its full amount, he can get from the principal debtor only the amount actually paid.

(b) . Actual payment either in cash or by transfer of property is essential for asking the principal debtor to pay. A promissory note given by the surety will not be sufficient to claim indemnity.

3.Right to be relieved from liability

The surety can ask the principal debtor to pay off his debts himself and relieve the surety from liability. Thus the surety can ask even before making any payment to the creditor. However he can do so only after the debt has become due.

C. Rights against co-sureties

Co-sureties: When a debt is guaranteed by two or more sureties, they are called co-sureties. In such a case all the co-sureties are liable towards the payment of the guaranteed debt as per the agreement among them.

Right to contribution

According to Sec. 146, "where two or more persons are co-sureties for the same debt or duty, 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, all 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.

Bound in different sums

According to Sec. 147, "Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit. Therefore the liability when apportioned equally will be subject to the maximum each one has guaranteed.

SURETIES LIABILITIES

1. Surety's liability is coextensive

The liability of surety is coextensive which means that the surety is liable to the same extent to which the principal debtor is liable.

2. Surety's liability may also be limited.

The surety may by special agreement limit his liability to a fixed amount. In such cases the surety's liability will not be more than the amount fixed by him.

3. Surety's liability arises immediately on default of principal debtor

The surety becomes liable to pay amount of guarantee as soon as the default is committed by the principal debtor. On default of the principal debtor the surety cannot ask the creditor to exhaust all the remedies open to him against the principal debtor before proceeding against the surety, he may sue the surety without saving the principal debtor. Moreover he may also sue them jointly.

4. Surety's liability where the original contract between creditor and principal debtor is void or violable.

the contract between the surety and creditor is an independent contract and not a collateral one. Thus it cannot be said that the surety will be liable only if the principal debtor is liable. Therefore when the original contract between the principal debtor creditor is void, the surety will remain liable. When the original contract is voidable at the option of principal debtor who has exercised his option and revoked the contract the surety may not be discharged from his liability. Moreover the surety is also not discharged where the creditor fails to sue the principal debtor within

the. period is otherwise available against the surety.

DISCHARGE OF SURETY FROM LIABILITY

A surety is to be discharged when his liability comes to an end. Circumstances in which a surety is discharged are discussed as follows

1. Notice of revocation (Sec 130)

A guarantee may be specific or continuing guarantee. A specific guarantee once given is irrevocable. Sec.130 of the Indian contract Act provides that, "a continuing guarantee may at any time be revoked by the surety, as the future transactions by notice to the creditor. However surety remains liable for transactions entered into the prior of the notice.

2. Death of surety (sec 131)

Sec. 131 of the act provides, "the death of the surety operates, in the absence of any contrary as revocation of continuing guarantee so far as regard to future transactions". The deceased surety's estate will not be liable for any transaction entered into after the death, even if the creditor has no **notice of the death.**

3. Novation (Sec 62)

Novation means the substitution of a new contract either between the same parties or parties for the old one. Thus the novation of a contract of guarantee discharges it

4. Variance in terms of contract (Sec 133)

According to Sec.133 of the act, "any variance, made without surety's consent in the terms of contract between principal debtor and the creditor discharges the surety as to the transaction subsequent to the variance.

5. Release (or) discharge of the principal debtor (Sec 134)

According to Sec. 134, "the surety is discharged by any contract between creditor and the principal debtor by which the principal debtor is released or by any act or omission of the creditor the legal consequences of which the discharge of the principal debtor".

6. Arrangement by creditor with principal debtor (Sec 135)

A contract between the creditor and principal debtor , by which the creditor makes a composition with or promises to give time to or not to sue, the principal debtor discharges the surety unless the surety asserts to such contract.

7. Impairing surety's remedy

According to Sec. 139, if the creditor does any act which is inconsistent with the 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 there by impaired, the surety is discharged.

8. Loss of security (Sec 141)

Sec 141 provides, "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 surety ship is entered into, whether the surety knows of the existence of such security or not and if the creditor losses or without the consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security. The word "loss" here means loss because of carelessness or negligence.

9. Misrepresentation Sec 142)

According to Sec 142, " 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, is invalid".

10. Concealment (Sec 143)

According to Sec 143, " Any guarantee which the creditor has obtained by means of keeping silence to material circumstances is invalid"

11. Failure of co-surety to join (Sec 144)

When 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.

12. Lack of essential elements

A contract of guarantee must have all the essential element of a contract. If it lacks any of the essential, the contract becomes void and the surety is discharged.