

Indemnity and Guarantee

Contract of Indemnity

- According to the Section 124 of the Indian Contract Act “ A Contract by which one party promises to save the other party from the 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 (promisor)
- The person whose loss is to be made good is called the indemnified or indemnity-holder(Promise)
- The Contract of Indemnity is a Class of contingent contract.

- A and B claim certain goods from a railway company as rival owners. A takes delivery of the goods by agreeing to compensate the railway company against loss in case B turns out to be the true owner. This is a contract of indemnity between A and the railway company.
- A and B go into a shop. B says to the shopkeeper “ let A have the goods, I will see you paid.” This is a contract of Indemnity.

Rights of Indemnity-holder when sued(Sec.125)

- According to section 125 an indemnity holder is entitled to recover from the promisor (i.e.indemnifier)
 - 1.All damages which he may be compelled to pay in respect of any matter in the suit to which the promise to indemnify applies.
 - 2.All costs which he may be compelled to pay in bringing or defending such suits.
 - 3.All sums which he may have paid under the terms of any compromise of any such suit. The compromise should not be contrary to the orders of the indemnifier and should be prudent or authorised by the indemnifier.

Essentials of a Contract of Indemnity

- There must be two parties in a contract of indemnity, i.e. Indemnifier and the Indemnified
- A Contract of Indemnity may be Express or implied
- The contract being a species of contract, is subject to all the rules of contract such as free consent, legality of object, capacity of parties etc.
- Consideration in the case of contract of Indemnity is essential to enable the indemnity holder to make claim for compensation
- A Contract of Indemnity is enforceable only when the Promisee suffers a loss the happening of which is unknown and against which the Indemnity holder was promised to be protected.

Contract of Guarantee

- It is a Contract to perform the promise or discharge the liability of a third person in case of his default.(Sec.126)
- The person who gives the guarantee is called the ‘ Surety’
- The person in respect of whose default the guarantee is given is called the ‘ Principal Debtor’
- The person to whom the guarantee is given is called ‘Creditor’.
- A Guarantee may be either Oral or Written
- It may be Express or Implied

Example

- S (Surety) requests C (Creditor) to lend Rs.1,00,000 to P(Principal Debtor) and guarantees that if P fails to pay the amount, he will pay. This is a Contract of Guarantee.

Bank of Bihar Ltd. Vs. Dr. Damodar Prasad

- Bank of Bihar Lent money to Damodar Prasad on the Guarantee of Mr. Paras Nath Sinha .
- The Guarantee Bond signed by Mr. Sinha in favour of the Bank stated that the surety would pay the liabilities of the Principal debtor up to Rs.12,000 and interest thereon within two days of the Demand.
- Damodar Prasad defaulted on paying back the principal and interest.
- The Bank sent several demand notices to both the parties but neither responded
- The Bank filed a suit against them in the Court of Patna.

- The Court decreed the Suit against both Mr. Prasad and Mr. Sinha.
- The Court further directed that the Bank should exhaust its remedies against Mr. Prasad before turning to the Surety Mr. Sinha.
- However the bank was not satisfied with the order of the Court as it was not as per the provisions of Section 128 of the Indian Contract Act and appealed to the Supreme Court.
- As per Sec.128 the liability of the surety is coextensive with that of the Principal Debtor unless it is otherwise provided by the Contract.

Decision of Supreme Court

- The Demand for payment of the liability of the Principal Debtor was the only condition for the enforcement of the bond.
- Neither the principal debtor nor the surety discharged the admitted liability of the principal debtor in spite of demands.
- Under Section 128 of the Indian Contract Act the liability of the surety is coextensive with that of the principal debtor. The Surety thus become liable to pay the entire amount.
- His Liability was immediate. It was not deferred until the creditor exhausted his remedies against the principal debtor.

- Before payment ,the surety has no right to dictate terms to the creditor and ask him to pursue his remedies against the principal in the first instance.
- In the absence of some special equity, the surety has no right to restrain an action against him by the creditor on the ground that the principal is solvent or that the creditor may have relief against the principal in some other proceedings.
- Similarly where the creditor has obtained a decree against the surety and the principal ,the surety has no right to restrain execution against him until the creditor has exhausted his remedies against the principal

Essential Features of a Contract of Guarantee

- 1. Concurrence
- 2. Primary Liability in some person
- 3. Essentials of a Valid Contract
- Writing not necessary

Extent of Surety's Liability

- 1.It's Co-extensive
- Under Section 128 of the Indian Contract Act the liability of the surety is coextensive with that of the principal debtor,unless it is otherwise provided in the Contract.
- The Surety is liable for what the principal debtor is Liable
- 2.Limitation of Surety's Liability
- 3.Liability under continuing guarantee(Sec.129)

Kinds of Guarantee

- 1. Specific Guarantee
- 2. Continuing Guarantee

Rights of Surety

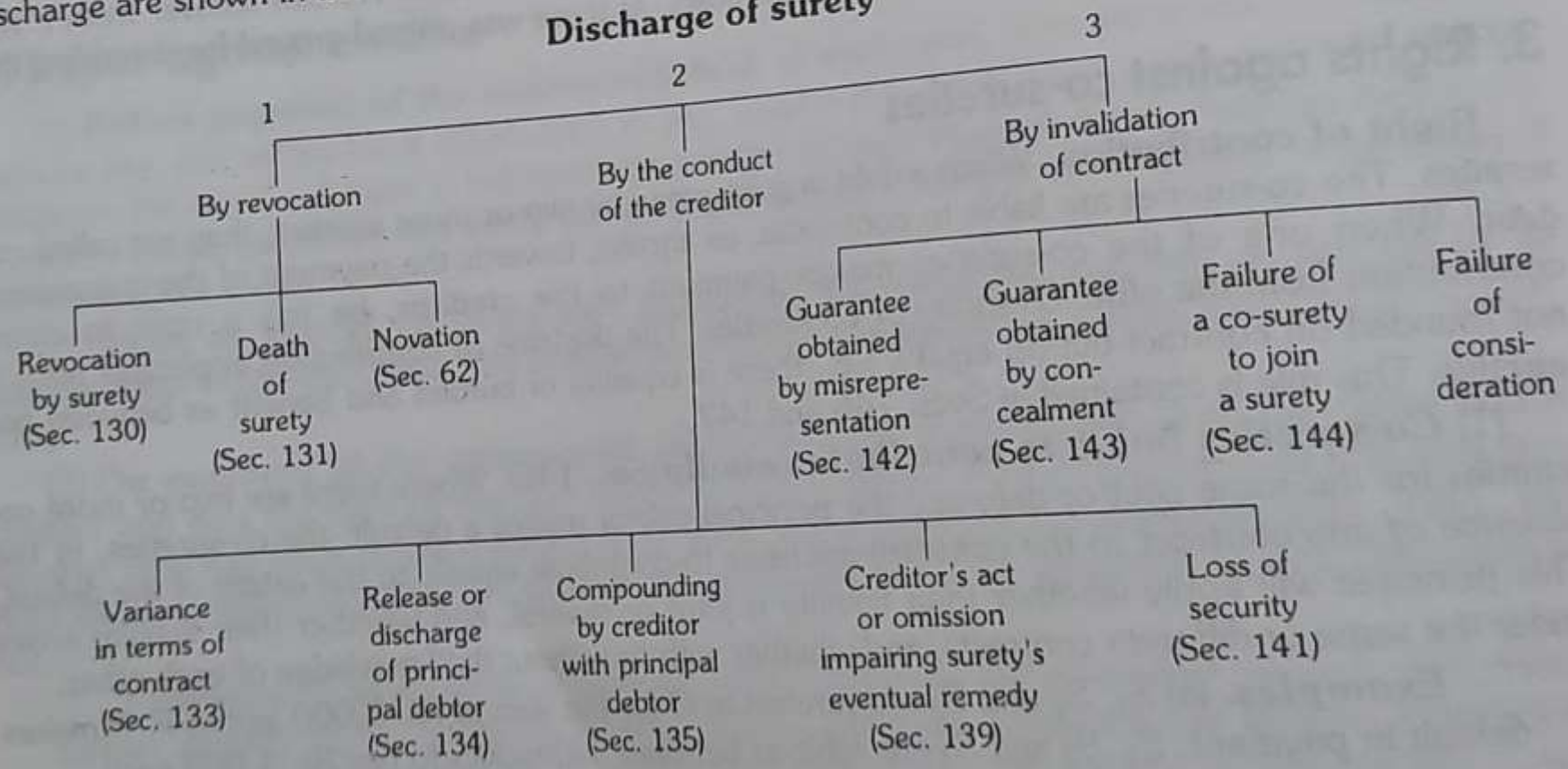
- The Surety has rights against
 1. The Creditor
 2. The Principal Debtor
 3. The Co-Sureties

them also to the other sureties (Sec. 138).

DISCHARGE OF SURETY

A surety is said to be discharged when his liability comes to an end. The various modes of his discharge are shown in the chart given below :

Discharge of surety



Distinction between a contract of indemnity and a contract of guarantee

Contract of indemnity

1. There are *two parties* to the contract, viz., the indemnifier (promisor) and the indemnified (promisee).
2. The liability of the indemnifier to the indemnified is *primary* and independent.
3. There is *only one contract* in the case of a contract of indemnity, i.e., between the indemnifier and the indemnified.
4. It is *not necessary* for the indemnifier to act at the request of the indemnified.
5. The liability of the indemnifier arises only on the *happening of a contingency*.
6. 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.

Contract of guarantee

1. There are *three parties* to the contract, viz., the creditor, the principal debtor and the surety.
2. The liability of the surety to the creditor is *collateral or secondary*, the primary liability being that of the principal debtor.
3. In a contract of guarantee, there are *three contracts* : one between the principal debtor and the creditor, the second between the creditor and the surety and the third between the surety and the principal debtor.
4. It is necessary that the surety should give the *guarantee at the request of the debtor*.
5. There is usually an *existing debt or duty*, the performance of which is guaranteed by the surety.
6. 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.*