

Course Name- LL.B 2nd sem
Subject- Special Contract Law
Teacher – Neeru Mangla
Concept –Contracts of Indemnity and
Guarantee

Contract of Indemnity and Guarantee

- Section 124 Contract of Indemnity
- Section 125 Rights of Indemnity
- Section 126 Contract of guarantee, surety, principal debtor and creditor
- Section 127 Consideration for guarantee
- Section 128 Nature of surety's liability
- Section 129 Continuing guarantee
- Section 130 Revocation of continuing guarantee
- Section 131 Revocation of continuing guarantee by surety's death
- Section 133 By variance in terms of contract
- Section 134 By release or discharge of principal debtor
- Section 135 Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor
- Section 136 Surety not discharged when agreement made with third person to give time to principal debtor
- Section 137 Creditor's forbearance to sue does not discharge surety
- Section 139 Discharge of surety by creditor's act or omission impairing surety's eventual remedy
- Section 140 Rights of subrogation
- Section 141 Surety's right to benefit of creditor's securities
- Section 142 Guarantee obtained by misrepresentation invalid
- Section 143 Guarantee obtained by concealment invalid
- Section 144 Guarantee on contract that creditor shall not act on it until co- surety joins
- Section 145 Implied promise to indemnify surety
- Section 146 Co-sureties liable to contribute equally
- Section 147 Liability of co-sureties bound in different sums

Contract of Indemnity (Section -124)

“Contract of Indemnity” defined (Section 124) : 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.” There are two parties in this form of contract. The party who promises to indemnify/ save the other party from loss is known as ‘indemnifier’, where as the party who is promised to be saved against the loss is known as ‘indemnified’ or indemnity holder.

- **Example 1 :** A may contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a sum of ` 5000/- advanced by C to B. In consequence, when B who is called upon to pay the sum of money to C fails to do so, C would be able to recover the amount from A as provided in Section 124.
- **Example 2 :** X, a shareholder of a company lost his share certificate. He applied for the duplicate. The company agreed to issue the same on the term that X will compensate the company against the loss where any holder produces the original certificate. Here, there is contract of indemnity between X and the company.
- **Explanation** To indemnify means to compensate or make good the loss. Thus, under a contract of indemnity the “existence of loss” is essential. Unless the promisee has suffered a loss, he cannot hold the promisor liable on the contract of indemnity. However, the above definition of indemnity restricts the scope of contracts of indemnity in as much as it covers only the loss caused :
 - (i) By the conduct of the promisor himself, or
 - (ii) By the conduct of any other person. Thus, loss occasioned by the conduct of the promisee, or accident, or an act of God is not covered. A contract of indemnity like any other contract may be express or implied. A contract of indemnity is like any other contract and must fulfill all the essentials of a valid contract like consideration, free consent, competency of contract, lawful object etc.
- **Example :** A asks B to beat C promising to indemnify him against the consequences. The promise of A cannot be enforced. Suppose, B beats C and is fined Rs. 1000, B cannot claim this amount from A because the object of the agreement is unlawful. A contract of Fire Insurance or Marine Insurance is always a contract of indemnity. But there is no contract of indemnity in case of contract of Life Insurance.

Rights of Indemnity—holder when sued (Section 125)

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

- (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.
- (3) All sums which he may have paid under the terms of any compromise of any such suit.

“Contract of guarantee”, “surety”, “principal debtor” and “creditor” [Section 126]

- **Contract of guarantee** : A contract of guarantee is a contract to perform the promise made or discharge the liability, of a third person in case of his default.

Three parties are involved in a contract of guarantee

- **Surety** - Person who gives the guarantee
- **Principal debtor** - Person in respect of whose default the guarantee is given
Creditor- Person to whom the guarantee is given
- **Example 1** : When A requests B to lend `10,000 to C and guarantees that C will repay the amount within the agreed time and that on C falling to do so, he will himself pay to B, there is a contract of guarantee. Here, B is the creditor, C the principal debtor and A the surety.
- **Example 2** : Where ‘A’ obtains housing loan from LIC Housing and if ‘B’ promises to pay LIC Housing in the event of ‘A’ failing to repay, it is a contract of guarantee.
- **Example 3** : X and Y go into a car showroom where X says to the dealer to supply latest model of Wagon R to Y. In case of Y’s failure to pay, X will be paying for it. This is a contract of guarantee because X promises to discharge the liability of Y in case of his defaults.

Explanation

Guarantee is a promise to pay a debt owed by a third person in case the latter does not pay. Any guarantee given may be oral or written. From the above definition, it is clear that in a contract of guarantee there are, in effect three contracts

- (i) A principal contract between the principal debtor and the creditor
- (ii) A secondary contract between the creditor and the surety.
- (iii) A implied contract between the surety and the principal debtor whereby principal debtor is under an obligation to indemnify the surety; if the surety is made to pay or perform. The right of surety is not affected by the fact that the creditor has refused to sue the principal debtor or that he has not demanded the sum due from him.

Consideration for guarantee [Section 127]

- As per Section 127 of the Act, “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.”
- Example 1 : 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.
- Example 2 : A sell and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year, and promises that if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is a sufficient consideration for C’s promise.

Essentials of a valid Guarantee

1. Existence of a principal debt.
2. Benefit to principal debtor is sufficient consideration, but past consideration is no consideration for a contract of guarantee.
3. Consent of surety should not be obtained by misrepresentation or concealment of a material fact.
4. Can be oral or written.
5. Surety can proceed against without proceeding against the principal debtor first.
6. If the co-surety does not join, the contract of guarantee is not valid.

Distinction between a Contract of Indemnity and a Contract of Guarantee

Contract of Indemnity

1. There are only two parties namely the indemnifier [promisor] and the indemnified [promisee]
2. There are three parties creditor, principal debtor and surety.
3. The liability of the indemnifier arises only on the happening of a contingency.
4. The indemnifier need not necessarily act at the request of indemnified
5. Indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour.
6. Only one original and independent contract between indemnifier and indemnified.

Contract of Guarantee

1. There are three parties creditor, principal debtor and surety.
2. The liability of the surety is secondary as the primary liability is that of the principal debtor.
3. Liability is already in existence but specifically crystallizes when principal debtor fails.
4. Surety must act by extending guarantee at the request of debtor
5. Surety can proceed against principal debtor in his own right because he gets all the right of a creditor after discharging the debts.
6. There are 3 contracts made between— • Creditor and principal debtor • Creditor and Surety • Surety and Principal debtor