

CONTRACT OF INDEMNITY

What is contract of indemnity?

- **Lay man's language:** Indemnity = Security against loss
- **Definition in English Law:** It is a promise to save a person harmless from the consequences of an act

What happens in a contract of indemnity? In a contract of indemnity one party promise to compensate the other party against the loss suffered by the other.

What are the characters/parties in Contract of Indemnity ?

- **Party I-** The person who is promising to pay compensation is called Indemnifier .
- **Party-II-** The person who's loss is compensated is called Indemnity holder.

Example: Insurance is a contract of indemnity !

CONTRACT OF GUARANTEE

What is contract of guarantee ?

- **Lay man's language:** A formal assurance to others liability
- **Legal Meaning:** A "contract of guarantee " is a contract to discharge the liability, of a third person in case of his default.

What happens in a contract of guarantee? When one person fails to discharge his liability, the other person assures to fulfill the same on behalf of the defaulter.

Who are the characters or parties in a contract of guarantee?

- Party I- The person who gives the guarantee is called the " surety"
- Party II- The person in respect of whose default the guarantee is given is called the " principal debtor "
- Party III- The person to whom the guarantee is given is called the " creditor ".

LAWXPERTSMV #COMPREHENSIVE NOTES

CONTRACTS : CONTRACT OF INDEMNITY, GUARANTEE AND INSURANCE

CONTRACT OF INDEMNITY

What is the definition of contract of indemnity?

Definition: Section 124- Indian Contract Act, 1872-

- a) **Contract of indemnity**= a contract where one party promises
- b) **Promises what ?** To save the other
- c) **From what ?** Any loss caused to him
- d) **By whom ?** By the conduct of promisor himself or any other person is called contract of indemnity.

Lx Explains: The insurance contract where the insurance company promises to pay for the damages suffered by the policyholder, against the premiums is a contract of indemnity

When a contract of indemnity could be enforced? It can be enforced only when liability of indemnifier arises.

When the liability of indemnifier arises? The liability of indemnifier commences only

- when the indemnified has actually suffered loss or
- when there is an apprehension that the indemnified by all chances is likely to suffer it # **Gajanan Moreshwar v Moreshwar Madan**

CASE LAW: Chand Bibi v Santosh Kumar Pal

Facts: The defendant's father promised to pay off mortgage debt incurred by the plaintiff and to indemnify him if they were made liable for the mortgage debt. The plaintiff sued him to pay the mortgage money.

Held: The suit was premature there was no damage incurred by plaintiff.

What are the rights possessed by the Indemnity Holder?

Relevant Provision- Section 125

An indemnity holder has following rights –

- **Right to recover damages** – he can get all damages which he paid in any suit in respect of in respect of any matter to which the promise of indemnity applies.
- **Right to recover costs** – He can get all costs incidental to the institution and defending of the suit.
- **Right to recover sums paid under compromise** – He can get all amounts which he paid in compromise of suit relating to indemnity.
- **Right to sue for specific performance** – He can sue for specific performance if he has incurred absolute liability and the contract covers such liability.

All the above is applicable only when the indemnity holder acts judicious as he would have acted in the absence of such indemnity contract.

Attention ! It is important to note here that the right to indemnity cannot be claimed of dishonesty, lack of good faith and contravention of the promisor's request. However, the right cannot be negated in case of oversight # **Yeung v HSBC**

Do indemnifier have only liability or has some rights? If so what are the rights of Indemnifier?

The below rights of the indemnifier are latent not expressed overtly in Act but can from section 141 which deals with the rights of surety, we can easily conclude that the indemnifier's right would also be same as that of surety.

Principle in case law: Simpson v Thomson : Where one person has agreed to indemnify the other, he will, on making good the indemnity, be entitled to succeed to all the ways and means by which the person indemnified might have protected himself against or reimbursed himself for the loss # ***He gets the rights of the indemnified after paying the compensation.***

What is the principle applied? Principle of subrogation – The indemnifier steps into the shoes of indemnity holder.

Reason : Law of indemnity is based on equity # **Maharaja Shri Jarvat Singhji v Secretary of State for India.**

CONTRACT OF GUARANTEE

What is the definition of Guarantee ?

Section: 126: A contract to perform the obligation or to discharge the liability of a third party in case of its default is called contract of guarantee.

Illustration:

If A gives an undertaking stating that if ` 200 are lent to C by B and C does not pay, A will pay back the money, it will be a contract of guarantee. Here, A is the surety, B is the principal debtor and C is the creditor.

What is the consideration for contract of guarantee?

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.

"There can be no contract of guarantee unless there is someone primarily liable." Comment. (11/II/5b/15)

What types of liabilities arise from contract of guarantee?

In case of guarantee contract there will be two types of liabilities namely;

- **Primary liability** – It is on the principal debtor
- **Secondary liability**- This liability goes to surety.

Why do we need contract of guarantee in practical world ?

The most basic function of a contract of guarantee is to enable a person to get a job, a loan or some goods as the case may be.

Lx Explains: Consider this circumstance a person is desirous of buying a car by making monthly payments but the car dealer asks for guarantee. Then someone would have to assure him that he will make the monthly payments in case of default by the buyer.

Such an undertaking results in a contract = surety ship or guarantee.

So what actually guarantee is ?

Guarantee is security in form of a right of action against a third party called the surety or the guarantor.

What are the essentials of contract of guarantee?

The Essentials of a Contract of Guarantee are:

Essential I- The existence of tripartite Agreement: A contract of guarantee requires three parties namely

- I. Principal creditor,
- II. Creditor and
- III. Surety.

Further in this contract of guarantee there is the involvement of three contracts.

- **Contract 1:** It is a contract between the principal debtor and the creditor **-debt agreement**, on the basis of which a guarantee for the debt arises.
- **Contract 2:** It is an agreement between the principal debtor and the surety in which the principal debtor accepts the responsibility to indemnify the surety if the payment is required to be made by the surety- **indemnity agreement**.
- **Contract 3:** It is a contract between the creditor and the surety in which the surety promises to undertake the payment of the debt of the principal debtor in case the principal debtor defaults on his payments- **actual guarantee agreement**.

Essentials II- It requires all essentials of a Valid Contract: It is a form of specific contract thus like any other general contract, it must contain

- free consent,
- consideration,
- lawful object and
- competency of contracting parties etc

Essential III- The principal debt must pre-exist: A contract of guarantee seeks to secure payment of a debt, thus it is necessary there is a recoverable debt. There can not be a contract to guarantee a time barred debt/ or there exist no debt.

What should be the form of Contract of guarantee? The contract of guarantee can be both oral and written .

Is a Contract of a Guarantee a Contract of Uberrimae Fidei?

What is Uberrimae fidei ?

Uberrimae fidei= contract 'requiring absolute good faith.' Which implies the parties to contract must act with pure thoughts as per equity.

Contract of insurance as contract of uberrimae fidei: Insurance contracts are the most common type of uberrimae fidei contract.

Reason: The insurance company agrees to share the risk of loss with the policyholder, it is imperative that the policyholder act in good faith by fully disclosing all information that affects the insurance company's level of risk.

Why full disclosure? Full disclosure allows the insurer to protect itself by charging the policyholder a premium that accurately reflects the level of risk it is undertaking or even refusing to issue a policy if the risk is too high # **Carter v Boehm**

Unfortunately ! A contract of guarantee cannot be called a contract uberrimae fidei .

Thus ! Due to this reason the principal debtor or the creditor may not disclose material facts to a surety before making a contract.

Lx Explains: If a guarantee is given to a bank, the bank may not inform the surety of the matters that pertain to the credit of the principal debtor.

But ! still the suretyship relationship is one of trust and confidence and the validity of the contract depends upon the good faith of the creditor. However, it is not a part of the creditor's duty to inform the surety about all his previous dealings with the principal debtor.

Therefore ! Even though contract of guarantee does not require utmost good faith – it requires minimum good faith, thus the provision of Section 142 and 143 give some protection to the surety by making the following guarantee as invalid.

- (a) A guarantee obtains by misrepresentation.
- (b) A guarantee obtained by concealment of material facts.

Illustration:

A guarantees to C payment for coal to be supplied by him to B to the amount of 2,000 tons. B and C have privately agreed that B should pay ` five per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

RIGHTS OF SURETY

Surety has rights against two 3 persons namely :- the creditor, the principal debtor and they are as follows:-

Right of the Surety as against Co-Sureties:

1. **Right to claim Contribution:** Surety can ask his co-sureties to contribute the amount when principal debtor comes across default.

Why ? If they have given guarantee for equal amounts, they have to contribute equally.

Law of England: As per England law contribution is to be made in the ratio of guarantee amounts.

Indian Law: As per Indian law the deficit amount is to be distributed to all sureties equally and every surety will contribute share of deficit or guarantee amount which ever is less.

2. **Right to claim for share in securities:** When co-sureties make payment to creditor, they get securities from creditors procession. Then every surety can claim his share in those securities.

Right of Surety as against the Creditor:-

1. **Rights of Sub-rogation:** When ever surety makes payment to creditor, creditor foregoes or loses all of his rights in his capacity as creditor and those rights will be attained by surety.

2. **Right to stay informed and consulted:** Sec. 133 – The creditor shall not change terms of the agreement between the creditor and the principal debtor without the surety's assent.

If violated – If any such variations made without consent of surety then this violation releases the surety as to transactions ensuing to the difference. **Exception-** However in the event that the change is for the profit of the surety or is of an irrelevant character, it might not have the impact of releasing the surety.

3. **Right to ask for Set-off:** Surety can give advice to creditor to sell away the security and to utilize the amount thus realized for set off.

4. **Right to get discharged when principal debtor is discharged: Sec. 134** – The liability of the surety is co-extensive with that of the principal debtor.

Thus ! the creditor if discharge the principal debtor from his liability under the agreement. The impact of the release of the principal debtor will release the surety too.

5. **Right to get Securities:** If Surety makes payment to creditor, surety can get all securities into his possession from creditor.

Right of Surety as Against the Principal Debtor

1. Right of Subrogation- After the payment of the debt to the creditor, the surety is subrogated to the rights of the creditor.

What it implies: He has the same rights as those of the creditors. Therefore, he can sue the principal debtor to exercise those rights.

Thus if the surety has performed his promise towards the creditor, all the rights of the principal debtor against the creditor devolve upon him.

2. Right of Indemnity- In every contract of guarantee, there is an implied promise by the principal debtor to indemnify the surety i.e., to compensate the surety.

What it implies: Therefore, upon the payment of debt of the principal debtor, the surety becomes entitled to recover from the principal debtor, all the amount including interest + costs rightly paid to the creditor under the guarantee.

Reason: Because the surety is entitled to full indemnification.

3. Right to be Relieved Earlier- A surety can, even before making any payment, compel the debtor to relieve him from liability by paying off the debt. But, before doing so, the debt should be ascertained.

LIABILITY OF SURETY

What is the basic principle about the liability of surety?

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

What it implies: When the principal debtor pays the debt – the liability of surety ceases, or when the principal

**"Liability of the surety is secondary."
Comment. (08/11/5c/20)**

debtor gets discharged the surety will also be discharged.

Further in *State Bank of India v. M/s. Indexport Registered*, it was held that the decree holder bank can execute the decree against the guarantor without proceeding against the principal borrower. Guarantor's liability is coextensive with that of the principal debtor.

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.

CONTINUING GUARANTEE

What is definition of Continuing Guarantee?

Provision: Section 129- a guarantee which extends to a series of transactions is called a continuing guarantee.

Lx Explains: A is an iphone dealer and B buys iphones from A at periodic intervals and sells in his store . C a friend of B provides guarantee to A for all transactions of B including future transaction- this is a continuing guarantee.

If later the surety wants to get away with his guarantee, what can he do?

A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.

DISCHARGE OF SURETY

What are the modes by which liability of surety gets discharged?

The secondary liability of the surety comes to an end by following modes:-

- Discharge by revocation of guarantee.
- Discharge by activities of creditor.
- Discharge by invalidation of guarantee contract.

DISCHARGE BY REVOCATION OF GUARANTEE

By the following modes the guarantee stands revoked.

1. By Notice:

What is revocation by notice?

Surety can revoke his guarantee by giving a notice to creditor.

In what type of guarantee this can be done?

Revocation of guarantee can be done only in continuing guarantee that too it applies only for future debts.

2. By Death: Whenever surety dies- the fate of his assurance is decided based on type of surety.

What happens in case of specific guarantee?

In case where surety has given specific guarantee legal representative has to take up the secondary liability absolutely.

What happens in case of continuing guarantee?

In case where surety has given continuing guarantee, legal representative is liable to the debts granted by creditor to principal debtor till the date of filing death notice by legal representative.

3. **By Renewal:** Whenever renewal of guarantee contract takes place, old guarantee comes to an end and new one comes into live.

Discharge by activities of creditor:

What does discharge by activities of creditor mean?

It means that whenever creditor renders any of the following activities, surety gets discharges from his liability.

1. **Material Alterations:** In case where creditor makes material alterations in guarantee contract deed, without consent of surety discharge of Surety takes place.

Case Law: Witcher Vs Hall.

Facts : Creditor fraudulently altered the deed of debt.

Held: Surety was discharged.

2. **Releasing principal debtor:** liability of surety is co-extensive with principal debtor thus, when primary liability of principal debtor discharged the surety also gets discharged # **Hewson Vs Ricketts.**
3. **Fraudulent activities of creditor or principal debtor or both:** If creditor collides with principal debtor and tries to defraud Surety, then also discharge of surety takes place # **Midlon motor show rooms Vs Newman.**
4. **Recovery from securities:** When the creditor realises his debt through the additional sureties given then both principal debtor and surety stands discharged.

Discharge by invalidation of guarantee contract: When guarantee contract becomes invalid then surety will have no secondary liability.

GUARANTEE VS INDEMNITY

THIS DIFFERENCE TWICE ASKED IN UPSC

CONTRACT OF INDEMNITY	CONTRACT OF GUARANTEE
Number of parties: 2	3
Names of parties: Indemnifier and Indemnity holder	creditor, Principal debtor and surety.
Number of Contracts: 1	3
Nature: As indemnity contract includes two parties and one contract, it can be said that indemnity contract is simple in nature.	But guarantee contract includes three parties and three sub-contracts and hence be said that guarantee contract is complex in nature.
Liabilities: In contract of indemnity there is no classification and sharing of liability where the absolute liability rests with indemnifier	In contract of guarantee there will be two types of liabilities namely; primary and secondary liabilities which will be with principal debtor and surety respectively.
Recovery methodology: In case of indemnity contract the indemnifier, after compensating indemnity holder's loss, cannot recover that amount from any person.	In contract of guarantee, if surety makes payment to creditor, he (surety) can recover that amount from principal debtor.
Interest of parties: Indemnity contract gets formed upon indemnifier's interest	Guarantee contract gets formed upon principal debtor's interest.

LAWXPERTSMV # REVISION NOTES

CONTRACTS : CONTRACT OF INDEMNITY, GUARANTEE AND INSURANCE

Contract of indemnity= Section 124= a contract where one party promises to save the other any loss caused to him by the conduct of promisor himself or any other person is called contract of indemnity,

When the liability of indemnifier arises? The liability of indemnifier commences only

- when the indemnified has actually suffered loss or
- when there is an apprehension that the indemnified by all chances is likely to suffer it # **Gajanan Moreshwar v Moreshwar Madan**

CASE LAW: Chand Bibi v Santosh Kumar Pal : Suit for paying indemnity was premature when there was no damage incurred by plaintiff .

Rights of Indemnity Holder: Section 125

- Right to recover expenses incurred in suit relating indemnity.
- Right to recover costs incidental to the institution and defending of the suit.
- Right to recover sums paid under compromise in such suits.
- Right to sue for specific performance

All the above is applicable only to a judicious indemnity holder # **Yeung v HSBC**

Rights of indemnifier = Simpson v Thomson : # *He gets the rights of the indemnified after paying the compensation.* The indemnifier steps into the shoes of indemnity holder# Principle of subrogation

CONTRACT OF GUARANTEE

Definition of Guarantee : Section: 126: A contract to perform the obligation or to discharge the liability of a third party in case of its default is called contract of guarantee.

Consideration for contract of guarantee = Anything done, or any promise made, for the benefit of the principal debtor.

Liability in contract of guarantee:

- **Primary liability** – It is on the principal debtor
- **Secondary liability**- This liability goes to surety.

The Essentials of a Contract of Guarantee :

Essential I: The existence of tripartite Agreement:

- **Contract 1: Debt agreement**- Between principal debtor and creditor.
- **Contract 2: Indemnity agreement**- Between principal debtor and surety
- **Contract 3: Actual guarantee agreement**- Between the creditor and the surety

Essentials II- It requires all essentials of a Valid Contract

Essential III- The principal debt must pre-exist.

Form of Contract of guarantee: It can be both oral and written .

Uberrimae fidei contracts:

- ✚ **Uberrimae fidei**= contract 'requiring absolute good faith.' Contract of insurance as contract of uberrimae fidei
- ✚ **Unfortunately !** A contract of guarantee not a contract of uberrimae fidei .
- ✚ **Thus !** Due to this reason the principal debtor or the creditor may not disclose material facts to a surety before making a contract.
- ✚ **Lx Explains:** If a guarantee is given to a bank, the bank may not inform the surety of the matters that pertain to the credit of the principal debtor.
- ✚ **But !** still the suretyship relationship is one of trust and confidence
- ✚ **Therefore !** Even though contract of guarantee does not require utmost good faith – it requires minimum good faith, thus the provision of Section 142 and 143 makes guarantee as invalid on misrepresentation and concealment of material facts.

RIGHTS OF SURETY

Right of the Surety as against Co-Sureties:

3. **Right to claim Contribution:** Surety can ask his co-sureties to contribute the amount when principal debtor comes across default. **Law of England:** contribution = ratio of guarantee amounts. **Indian Law:** Contribution = share of deficit or guarantee amount which ever is less.

4. **Right to claim for share in securities** : When co-sureties make payment to creditor, they get securities from creditors procession.

Right of Surety as against the Creditor:-

1. **Rights of Sub-rogation:** Surety gets creditors rights after payment.
2. **Right to stay informed and consulted-** alteration of contract without approval of surety discharges him# Sec. 133
3. **Right to ask for Set-off:** Surety can give advice to creditor to sell away the security and to utilize the amount thus realized for set off.
4. **Right to get discharged when principal debtor is discharged # Sec. 134**
5. **Right to get Securities from creditor after payment.**

Right of Surety as Against the Principal Debtor

1. **Right of Subrogation-** After the payment of the debt to the creditor, the surety is subrogated to the rights of the creditor.
2. **Right of Indemnity-** In every contract of guarantee, there is an implied promise by the principal debtor to indemnify the surety i.e., to compensate the surety.
3. **Right to be Relieved Earlier-** A surety can, even before making any payment, compel the debtor to relieve him from liability by paying off the debt.

LIABILITY OF SURETY

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

What it implies:

- 1) When the principal debtor gets discharged the surety will also be discharged.
- 2) Creditor can sue surety for money without proceeding against principal debtor # *State Bank of India v. M/s. Indexport Registered.*

CONTINUING GUARANTEE

Definition: Provision: Section 129- a guarantee which extends to a series of transactions is called a continuing guarantee.

Revocation : A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.

DISCHARGE OF SURETY

The secondary liability of the surety comes to an end by following modes:-

- Discharge by revocation of guarantee.
- Discharge by activities of creditor.
- Discharge by invalidation of guarantee contract.

DISCHARGE BY REVOCATION OF GUARANTEE

By the following modes the guarantee stands revoked.

1. **By Notice:** Surety can revoke his guarantee by giving a notice to creditor only in continuing guarantee for future debts.
2. **By Death:** Whenever surety dies - **Specific guarantee**- legal representative has to take up the secondary liability absolutely. **Continuing guarantee**= legal representative is liable to the debts granted till the date of filing death notice by legal representative.
3. **By Renewal:** Whenever renewal of guarantee contract takes place, old guarantee comes to an end and new one comes into live.

DISCHARGE BY ACTIVITIES OF CREDITOR:

1. **Material Alterations:** Creditor makes material alterations in guarantee contract deed, without consent of surety discharge of Surety occurs # **Witcher Vs Hall**.
2. **Releasing principal debtor:** Principal debtor discharged the surety also gets discharged # **Hewson Vs Ricketts**.
3. **Any fraudulent activities of creditor or principal debtor or both discharges the surety**# Midlon motor show rooms Vs Newman.
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