

INDEMNITY AND GUARANTEE

Anticipated
Loss

CONTRACT OF INDEMNITY

Meaning and Definition

The term indemnity means to make good or to compensate the party who has suffered loss. A contract to indemnify a person from loss is known as contract of indemnity.

Section 124 states, "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 (promisor). The person whose loss is to be made good is called the indemnity holder or indemnified (promisee).

EXAMPLES

- A parked his cycle at a cycle stand. A lost the token issued by B. B refused to return the cycle. To get back his cycle, A promised to compensate B against any loss he may suffer if any other person claims the cycle from B.
- C owes Rs. 2 lac to B. The claim is disputed. A, a friend of B, contracts to indemnify B against the result of any suit which C may bring against B for sum of Rs. 2 lac. It is a contract of indemnity.
- A transport company possesses certain goods. X claims the goods showing that he is the true owner. The company delivers the goods to X. Later, Y proves that he is the true owner and gets compensation from the company. X is liable to indemnify the company for such loss.

Essentials

The following are the essentials of a valid contract of indemnity:

1. Special Contract

It is a special type of contract. All the essentials of a valid contract are also required for contract of indemnity. It may be expressed or implied. It is a kind of contingent contract.

2. Loss of Party

A person can indemnify another person only if such other person suffers some loss. A contract of indemnity can be performed only when the loss has incurred to the promisee.

3. Indemnity by Promisor

The purpose of the contract of indemnity is to protect the indemnity holder from loss which may be caused to the indemnity holder in future.

4. Reason for Loss

The contract for indemnity may specify that indemnity holder shall be protected from loss caused due to the action of the promisor or any other person or any act, event or accident which is not in the control of the parties.

Rights of Indemnity Holder

The following are rights of indemnity holder: [Sec. 125]

Expenses

1. Right to Recover Damages

Indemnity holder can recover from indemnifier all damages which he may be compelled to pay in respect of any suit filed against him.

2. Right to Recover Cost of Suit

The indemnity holder can recover from indemnifier expenses in respect of any suit filed by him with the authority of indemnifier.

3. Right Recover Sums

The indemnity holder can recover from indemnifier all amount which he has paid as a result of any compromise of the suit.

Rights of Indemnifier

There is no provision in the law about the rights of indemnifier. However, the rights of indemnifier are the same as the rights of a guarantor. It is a principle of law that where one person has agreed to indemnify another, his rights will be similar to the rights of guarantor.

To perform the CONTRACT OF GUARANTEE / surety

Meaning and Definition

The term guarantee may be defined as an undertaking by one person to pay the amount due from another person. A contract to pay the amount due from another person, in case the latter fails to pay, is known as contract of guarantee.

Section 126 states, "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 contract of guarantee is made to enable a person to get loans, goods on credit, employment etc. It may be oral or written. The person who gives the guarantee is called the surety or guarantor. The person to whom the guarantee is given is called the creditor. The person in respect of whose default the guarantee is given is called the principal debtor

EXAMPLES.

- a. A requests B to lend Rs. 5 Lac to C. A guarantees that if C fails to return the loan, A will pay to B. This is a contract of guarantee.

indemnity surety surety contract

credit

Employment
Goods - Credit

b. On the request of B, A promises to the employer of B that if B commits a fraud, A shall be liable. This is a contract of guarantee.

Essentials

The following are essential features of contract of guarantee:

1. Tripartite Contract

It is an agreement between the principal debtor, creditor and surety. Three separate contracts exist among them. All the essentials of a valid contract are also required for a contract of guarantee.

In a contract of guarantee, the principal debtor is liable and the surety becomes liable on the default of principal debtor. The principal contract exists between the principal debtor and creditor and the secondary contract exists between the creditor and surety.

EXAMPLE

X takes a loan of Rs. 5000 from Y on the guarantee of Z. The agreement between X and Y is the principal contract and the contract between Y and Z is a contract of guarantee. The liability of Z will arise if X fails to repay the loan.

2. Consideration

It must be supported by some consideration. It is not necessary that there is direct consideration between the surety and creditor. A consideration received by the principal debtor is sufficient for the surety and it is not necessary that it must result in some benefit to the surety himself. [Sec. 127]

EXAMPLES

- a. A sells goods on credit to B on C's guarantee. C's promise to guarantee is the consideration for A's promise to sell the goods.
- b. A sells goods to B. X requests A not to sue B for a week, and promises to pay if B does not pay. It is consideration for X's promise.

3. Misrepresentation

A guarantee obtained by means of misrepresentation made by the creditor or with his knowledge and assent, concerning the material part of a transaction, is invalid. If the consent of surety is obtained by misrepresentation, the surety will be discharged from his liability. [Sec. 142]

EXAMPLE

H was invited to give guarantee for the honesty of L's servant. L had previously dismissed his servant for dishonesty but did not disclose this fact to H. Later, the servant committed embezzlement. H was held not liable. (LGO Co. vs. Holloway)

4. Concealment

Any guarantee which the creditor obtains by means of keeping silence

Discharge the liability

regarding material circumstances is invalid. The expression 'keeping silence' means intentional concealment of the facts. The creditor should disclose to the surety the facts which are likely to affect the surety's liability. [Sec. 143]

EXAMPLE

A employs B to recover money. B misappropriates the money. Later, A asks C for surety. C being unaware of B's previous record gives guarantee for B. B again misappropriates. C's guarantee is invalid because A concealed the facts.

5. Primary Liability

There must be a primary liability of some person other than the surety. The liability must be enforceable at law. If liability does not exist, there cannot be a contract of guarantee.

6. Writing not Necessary

The contract of guarantee may not be in writing. The contract may be either oral or written. It may be express or implied. The implied guarantee may result from the conduct of parties. [Sec. 126]

EXAMPLE

A sells and delivers goods to B on the verbal guarantee of C. It is a valid guarantee.

7. Capacity of Parties

The parties to a contract of guarantee must be competent to contract. Incapacity of the principal debtor does not affect the validity of a contract of guarantee. However, the other parties must be competent to contract.

EXAMPLE

F, a minor, takes a loan from G. W gives guarantee to G for the repayment of loan if F refuses to pay. It is a valid contract.

DIFFERENCE BETWEEN INDEMNITY AND GUARANTEE

The following are differences between the two:

INDEMNITY	GUARANTEE
<p>1. Number of Parties There are two parties: indemnifier and indemnity holder.</p>	<p>There are three parties: creditor, principal debtor and surety.</p>
<p>2. Number of Contract There is one contract between indemnifier and indemnified.</p>	<p>There are three contracts: between creditor and principal debtor, creditor and surety, surety and principal debtor.</p>
<p>3. Nature of Liability The liability of indemnifier is primary in nature.</p>	<p>The liability of surety is secondary in nature. The primary liability is of</p>

4. Request

It is not necessary for indemnifier to act on the request of indemnity holder.

5. Existence of Liability

Liability of the indemnifier arises when indemnity holder suffers a loss.

6. Filing of Suit

The indemnifier cannot sue the third party for loss in his own name. He can sue if the claim is assigned in his favor.

7. Purpose

The indemnifier promises to save indemnity holder from any loss.

principal debtor.

It is necessary that surety should give guarantee on the request of principal debtor.

Liability of surety arises on the default of principal debtor.

The surety after paying to creditor can sue principal debtor in his own name.

The surety promises to pay debt or perform promise if principal debtor makes default.