

CHAPTER -- VIII

OF INDEMNITY AND GUARANTEE

124. "Contract of indemnity" defined. 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".

Illustration

A, contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of 200 rupees. This is a contract of indemnity.

125. Right of indemnity-holder when sued. The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor---

(1) all damages which he may be compelled to pay in any such 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 suit if, in bringing or defending it, 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 authorised 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 in the absence of any contract of indemnity, or if the promisor authorized him to compromise the suit.

126. "Contract of guarantee", "surety", "principal" "debtor" and "creditor". A "contract of guarantee" is a contract to perform the promise, or discharge the liability of a third person in case of his default. 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", and the person to whom the guarantee is given is called the "creditor." A guarantee may be either oral or written.

S. 126-Bank guarantee-contention of the Bank was that the conduct of the plaintiff was mala fide, inasmuch as for about six years the plaintiff did not take any step towards recovery of decretal amount and that the plaintiff held 33% shares in the company-Validity-Responsibility of the Bank, in terms of the guarantee, would not become inoperative and it was the right of the plaintiff to seek remedy against the respondent, irrespective of its share, if any, in the company. PLD 2003 SC 215

Court Decision

Scope - Liability of guarantor depends on the language of the guarantee - Terms of the guarantee would demonstrate how far the guarantor has bound itself to indemnify the creditor - Guarantee may be absolute or conditional, dependant on the performance of a condition by either party within the terms of the guarantee. **PLD 2002 S.C1100** Company Judge to order encashment of Bank guarantee given on behalf of the company in liquidation - Bank had undertaken to pay a specified amount to the creditor (financial institution) if the borrower failed to raise capital within the stipulated period - No condition whatsoever was attached to the performance of the creditor before making demand - Guarantee was extended from time to time - Time limit in the guarantee was for the borrower, to raise the capital within the stipulated period, failure whereof had given unconditional right to the creditor for encashment of Bank guarantee - No time limit having been provided for the creditor, as such the direction given by the Company Judge could not be frustrated on that score - Contention that separate suit should have been filed for encashment of Bank guarantee and the Company Judge had no Jurisdiction to order encashment of the same in liquidation proceedings was devoid of any force. **PLD 2002 S.C1100** Discount Bank of India Ltd., Delhi v. Triloki Nath and others AIR 1953 PunJ. 145; Knowles v. Scott (1891) 1 Ch. 717; Palmer's Company Law, p.414; Manager, Jammu and Kashmir, State Property in Pakistan v. Khuda Yar and another PLD 1975 SC 678 and Imtiaz Ahmad v. Ghulam Ali PLD 1963 SC 382 ref.

When the Bank guarantee had formed part of the principal contract covered by the arbitration clause therein, could such a guarantee be encashed without recourse to arbitration and that when the contract project had already been completed of which respondent was taking full advantage, was that equitable, in any case, on the part of the respondent to encash the Bank guarantee. **PLD 2003 SC 295**

“Contract of guarantee” and “mobilization advance guarantee”--Rights and liabilities of the parties in case of contract of guarantee-Determination-Such rights are strictly determined with reference to terms and conditions of the guarantee without recourse to any other instrument or document executed by the parties for any other different purpose-Mobilization advance guarantee is on different footing than guarantees of other nature, in such a case, the liability of surety would be the entire amount due from principal-debtor-Principal-debtor in such case normally receives consideration in case of any revocation, termination or completion of contract-Bank guarantee being a distinct contract not controlled by the primary contract between the parties, contention that in view of various terms of the primary contract it would be more appropriate if the Court ordered to maintain status quo till the dispute was finally decided in terms of arbitration clause to which the parties had agreed, was repelled for such order would for all practical purposes nullify the contract of guarantee, which was an independent contract. **PLD 2003 SC 295**

“Guarantee”-Definition-Guarantee is an accessory contract, whereby promisor undertakes to be answerable to promisee for the debt, default or miscarriage of another person, whose primary liability to the promisee must exist or be contemplated. **PLD 2003 SC 191**

Bank guarantee furnished by surety--Variation in terms of agreement--Proof - Burden to prove that original Bank guarantee furnished by surety stood varied in terms of agreement subsequent to Bank guarantee, would be upon surety/defendant--Such surety having failed to discharge onus of proof, would be bound to pay guaranteed amount on demand. **P L D 1989 Kar. 168**

Bank guarantee-Guarantee rights and liabilities of the parties, are determined with reference to the terms and conditions of the guarantee and a contract of a guarantee is to be strictly construed in terms of the guarantee-Guarantee, in the present case, unequivocally postulated that the total responsibility of the Bank was restricted to a specified amount-Bank irrevocably and unconditionally undertook to pay the said amount to the plaintiff had sustained damages on the ground of default-Effect - Liquidated damages, as a rule, required the positive evidence to show that the actual loss was suffered by the party claiming the damages and even fixed amount stipulated for liquidated damages could not be recovered if the quantum of actual loss was not proved-Plaintiff, in circumstances, was neither entitled to any interest nor to any amount as liquidated damages. **PLD 2003 SC 215**

Bank guarantee in Banking system has dual aspect, same being a contract between Bank and beneficiary by a third party-Enforceability of Bank guarantee depends upon the terms under which guarantor has bound himself, who cannot be made liable beyond what he has undertaken-Obligations arising under Bank guarantee are independent of the obligations arising out of the specific contract between parties-Bank guarantee comes to an end, once same is discharged. **PLD 2003 SC 191**

Condition imposed in Bank, guarantee with regard to encashment - Bank guarantee executed in favour of the defendant contained a built in condition to the effect that its encashment would depend upon violation of conditions of the tender - Plaintiff who had tendered the guarantee assailed the act of encashment of the guarantee in civil suit - Both the Courts below declined to grant interim injunction against encashment of Bank guarantee - -Validity - Where violation/breach could not be determined without conducting inquiry, departure could be made from the rule mentioned in S.126 of the Contract Act, 1872 - Till final decision of the suit filed by the defendant the Bank guarantee could not be encashed - Leave to appeal was granted by S.C in circumstances. **2002 CLC 1012 = 2002 SCMR 1781** Sirafi Trading Establishment v. Trading Corporation of Pakistan Ltd. 1984 CLC 381; Messrs Arul Murugan Traders v. Rashtriya Chemicals and Fertilizers Ltd., Bombay and another AIR 1986 Mad. 161; Kudremukh Iron Ore Co. Ltd. v. Korula Rubber Co. Pvt. and another AIR 1987 Karnataka 139; Messrs Synthetic Foams Ltd. v. Simplified Concrete Piles (India) Pvt. Ltd. AIR 1988 Delhi 207; S. Chand & Co. Ltd. v. Dr. K. Shivarama Karantha and others AIR 1990 NOC 178 (Kant.); State Associates v. Messrs Farben Industrial Development SPA and another 1992 MLD 1007; Messrs Zeenat Brother (Pvt.) Ltd. v. Aiwan-e-Iqbal Authority through Chairman, Lah. and 3 others PLD 1996 Kar. 183; Generale Biscuit, A French Company through Mr. Benoit Barne and another v. Messrs Diamond Food Industries (Pvt.) Ltd. through Chief Executive/Director/Secretary 1999 YLR 305; Messrs Kohinoor Trading (Pvt.) Ltd. v. Mangrani Trading Co. and 2 others 1987 CLC 1533; Messrs Rafidian Bank, Iraq v. M.L. International (Pvt.) Ltd., Kar. and 3 others 1993 MLD 1234; Pakistan Engineering Consultants v. Pakistan International Airlines Corporation and BCCI and others 1993 CLC 882; Messrs National Construction Co. Ltd. v. Aiwan-e-Iqbal Authority PLD 1994 SC 311; Haral Textiles Limited v. Banque Indosues Belgium, SA and others 1999 SCMR 591 and Pakistan

National Shipping Corporation PNSC Building, Kar. v. Samsung Co. Ltd. and 3 others 2001 CLC 1473 ref.

Contract of guarantee, Parties to original contract mere in litigation with each other - Dispute was with regard to encashment of Bank guarantee during litigation by the Bank - Validity - Bank guarantee was independent contract between the Bank and the party in whose favour the guarantee had been furnished - Where the original parties to the main contract were litigating with each other, encashment of irrevocable Bank guarantee could not be declined by the Bank on the pretext of such litigation. **2002 CLC 1012** Messrs National Construction Co. Ltd. v. Aiwan-e-Iqbal Authority PLD 1994 SC 311 ref.

Financial Institution was creditor while the guarantee was provided by a Bank which was surety - Said guarantee had been executed for the benefit of the company (creditor) now under liquidation - Essence of the guarantee was that the guarantor had agreed to discharge the liability of the debtor if the latter failed in performing his liability which all depended on the terms of the guarantee and guarantor could not be made liable beyond the terms of his guarantee - Whatever the guarantor had undertaken, the same had to be performed - Guarantee having been executed by the Bank, satisfaction of the same could not be avoided on mere technicalities. **PLD 2002 S.C1100** Prudential Commercial Bank Limited v. Hydari Ghee Industries Limited and others 1999 MLD 1694 ref.

Contract of guarantee, encashment of -- Dispute was with regard to encashment of Bank guarantee during litigation by the Bank - -Validity - Bank guarantee was independent contract between the Bank and the party in whose favour the guarantee had been furnished - -Where the original parties to the main contract were litigating with each other, encashment of irrevocable Bank guarantee could not be declined by the Bank on the pretext of such litigation. **2002 SCMR 1781** Messrs National Construction Co. Ltd. v. Aiwan-e-Iqbal Authority PLD 1994 SC 311 ref.

Essential ingredients-Test to determine nature of guarantee and its effect-Guarantee contains the ingredients of "dedicated commitment", "absolute undertaking", "an unambiguous assurance", "unconditional willingness", "definite certainty", "compliance without objections", "sacred obligation" and "defined responsibility"-Nature of guarantee and its binding effect can be well-judged on the basis of such ingredients constituting a guarantee. **PLD 2003 SC 191**

Powers of Company Judge and function of Official Liquidator:-- Bank guarantee which was executed for the benefit of the company under liquidation could not be frustrated by putting up technicalities so as to thwart the efficient performance of the liquidator - Pushing the creditor for encashment of Bank guarantee through a civil suit would simply be generating multiplicity of litigation which was not the mandate of law - Mere technicalities unless offering insurmountable hurdle not to be allowed to defeat ends of Justice. Section 316 of the Companies Ordinance has given the Company Judge overriding powers for disposing of any matter germane to the winding-up proceedings. The principal object of winding-up of a company is to realize its property and its liabilities are discharged in accordance with law. The official liquidator who is an officer of the Court is appointed by the Company Judge who looks after and supervises the interests of all the parties concerned in a liquidation of a company. He is a trustee not only for the creditor but for the company under liquidation as well. He has to safeguard the interests of all the parties for the efficient performance of his duties. He is to take possession of movable and immovable properties of the company. Section 333 of the Ordinance has given wide powers to the official liquidator which are exercised by him under the supervision of Company Judge who has been authorized to issue such directions. The official liquidator has got ample powers to take steps for the efficient winding-up of the company so as to create a balance among the interest of the parties according to law and the rules. In a winding-up the liquidator acts not merely for creditor but for contributories and for the company also. A liquidator is an agent employed for the purpose of winding-up of the company. In some respects he is a trustee; but he is not a trustee for each individual creditor: see Knowles v. Scott (1891) 1 Ch. 717 at p. 723. His principal duties are to take possession of assets, to make out the requisite lists of contributories and creditors, to have disputed cases adjudicated upon, to realize the assets subject to the control of the Court in certain matters and to apply the proceeds in payment of the company debts and liabilities in due course of administration, and, having done that, to divide the surplus amongst the contributories and to adjust their rights. Any proceedings necessary for the protection of the property are taken by the liquidator in the name of the company, unless the Court has made a vesting order, in which case he can sue in his official name in respect of property vested in him by the order. He can institute or defend any suit with the sanction of the Court and he can take any other

legal proceedings, civil or criminal, also with such sanction. In the present case the bank guarantee was got executed for the benefit of the company under liquidation by the Bank as such the same could not be frustrated by putting up technicalities so as to thwart the efficient performance of the liquidator. What was permissible for the Courts of general Jurisdiction in the interest of Justice, fairplay and equity when there was no statutory bar, was also permissible for the Company Judge so as to spare the parties from the ordeal of rushing from one forum to another for the redress of their grievance. All legal formalities were to safeguard the paramount interest of Justice. In the present case pushing the creditor for the encashment of bank guarantee through a civil suit would simply be generating multiplicity of litigation which was not the mandate of law. The guarantor in the present case particularly the Bank could not avoid its liability on all these technicalities. Mere technicalities, unless offering insurmountable hurdle, should not be allowed to defeat the ends of Justice. **PLD 2002 S.C1100** Discount Bank of India Ltd., Delhi v. Triloki Nath and others AIR 1953 PunJ. 145; Knowles v. Scott (1891) 1 Ch. 717; Palmer's Company Law, p.414; Manager, Jammu and Kashmir State Property in Pakistan v. Khuda Yar and another PLD 1975 SC 678 and Imtiaz Ahmad v. Ghulam Ali PLD 1963 SC 382 ref.

127. Consideration 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.

Illustrations

(a) B request 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.

(b) A sells 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.

(c) A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

128. Surety's liability. The liability of the surety is coextensive with that of the principal debtor, unless it is otherwise provided by the contract.

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.

129. "Continuing guarantee". A guarantee, which extends to a series of transactions, is called a "continuing guarantee".

Illustrations

(a) A in consideration that B will employ C in collecting the rent of B's zamindari, promises B to be responsible to the amount of 5,000 rupees, for the due collection and payment by C of those rents. This is a continuing guarantee.

(b) A guarantees payment to B, a tea-dealer, to the amount of Rs. 100, for any tea he may from time to time supply to C B supplies C with tea to above the value of Rs. 100, and C pays B for it. Afterwards B supplies C with tea to the value of Rs. 200. C fails to pay. The guarantee given by A was a continuing guarantee, and he is accordingly liable to B to the extent of Rs. 100.

(c) A guarantees payment to B of the price of five sacks of flour to be delivered by B to C and to be paid for in a month. B delivers five sacks to C. C pays for them. Afterwards B delivers four sacks to C which C does not pay for. The guarantee given by A was not a continuing guarantee, and accordingly he is not liable for the price of the four sacks.

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

Illustrations

(a) A, in consideration of B's discounting at A's request, bills of exchange for C, guarantees to B, for twelve months, the due payment of all such bills to the extent of 5,000 rupees. B discounts bills for C to the extent of 2,000 rupees. Afterwards, at the end of three months. A revokes the guarantee. This revocation discharges A three months. A revokes the guarantee. This revocation discharges A to B for the 2,000 rupees on default of C.