

Laws of Indemnity and Guarantee

Definition: A Contract by which one party promises to save the other from loss caused to him
- by the conduct of the promisor himself
- by the conduct of any other person
is called a contract of Indemnity.

The loss must be caused by some human agency.

- Contingent Contract
- Express or Implied Contract
- Objective : To save the indemnified from loss
- Liability of Indemnifier: Primary, Absolute, Total
- Indemnifier cannot sue third person.

Parties:

- 1) **Indemnifier:** The person who makes the promise of indemnity is called indemnifier.
- 2) **Indemnified (Indemnity Holder):** The person with whom the promise of indemnity is made is called Indemnified or Indemnity holder.

Rights of Indemnified (When sued): The indemnified in a contract of indemnity is entitled to recover from his indemnifier:

- 1) **Damages:** All damages which he may be compelled to pay in any suit in respect of any matter to which indemnity applies.
- 2) **Cost:** All cost which he may be compelled to pay in any such suit:
 - if (in bringing or defending it) he did not contravene the orders of the indemnifier.
 - if he acted as if would have been prudent for him to act in the absence of any contract of indemnity.
- 3) **Sums:** 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 indemnifier.

Contract of Guarantee / Suretyship: A contract:

- to perform the promise, or
 - to discharge the liability
- of a third person in case of his default is called a contract of guarantee.

- Guarantee: An Express contract

Parties:

- 1) **Surety (Guarantor):** The person who gives the guarantee is called the surety.
- 2) **Creditor:** The person to whom the guarantee is given is called creditor.

3) **Principal Debtor:** The person in respect of whose default the guarantee is given is called Principal Debtor.

Guarantee: A Package of Contracts:

An implied contract of Indemnity.

Consideration for Guarantee:

- Any thing done
- Any promise made

for the benefit of the Principal Debtor is the sufficient consideration to the surety for giving the guarantee.

Nature and Extent of Surety's Liability:

- At the time of making of contract of guarantee, the surety is at liberty to state the limit of his liability
- In such a case, the surety is liable only to the extent of his **stated limit** on the default of the principal debtor.
- In the absence of any such contract, the liability of the surety is **co-extensive** with that of the principal debtor.
- Whatever the case may be, the liability of the surety is secondary and conditional that is it arises on the default of the principal debtor.

Kinds of Guarantee:

- 1) **Specific Guarantee:** A guarantee given for a single particular transaction, undertaking or debt is the specific guarantee. Once it has been upon by the creditor, the surety cannot revoke it.
- 2) **Continuing Guarantee:** A Guarantee which extends to a series of transactions is called Continuing guarantee.

Revocation of Continuing Guarantee:

- 1) **By Notice:** A continuing guarantee may be revoked at any time by the surety by giving notice to the creditor but only for future transactions.
- 2) **By Death (of surety):** In the absence of any special contract, a continuing guarantee is revoked by the death of surety but only for future transactions.

Invalid Guarantee:

- 1) **Guarantee obtained by Misrepresentation:** Any guarantee which has been obtained by means of misrepresentation made by the creditor, or with his knowledge and assent, concerning a material part of the transaction, is invalid.

- 2) **Guarantee obtained by Concealment:** Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.
- 3) **Failure of Co-surety to join:** Where a person gives a guarantee upon a contract that the creditor shall not act upon it until another person has joined in it as co-surety, the guarantee is invalid if that person does not join.

Rights of Surety:

Against Creditor:

- 1) **Right to securities:** A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time of making a contract of guarantee. This is immaterial whether the surety is or is not aware of the existence of such security.

Securities: Jewellery, Expensive Items

- 2) **Right of Set-off:** The surety is entitled (in a suit filed by the creditor against the surety) to the benefit of any set-off for counter claim which the principal debtor might possess against the creditor.
- 3) **Right to Quia-Timet** (because he fears or apprehends) **action:** The surety has a right at any time after the guarantee debt has become due and before he called upon to pay to require the creditor to sue the principal debtor for the performance of promise. However the surety must undertake to indemnify the creditor for the risk of delay and expenses which he may incur by so doing.

Against Principal Debtor:

- 1) **Right of Subrogation:** The terms subrogation may be defined as the substitution of one person with another with same right and liabilities.

After discharging his liability on the default of principal debtor, the surety is vested with all the rights which the creditor has against the principal debtor, for e.g.

- a) Right to securities (if any) held by creditor.
- b) Right to initiate proceedings against the principal debtor in his own name.

- 2) **Right to Indemnify:** The surety is entitled:
 - to an indemnity from the principal debtor
 - to recover any sum he has paid rightfully under the Guarantee.

Against Co-Sureties:

- 1) **Right of Contribution:**
 - Where a debt is guaranteed by two or more persons
 - * and one of them pays more than his share of that debt, he is entitled to compel contribution from the other(s).

- Co-sureties need not to be bound under the same contract,
* the right to contribution being independent of any agreement for that purpose.
- If the co-sureties are bound indifferent sums,
* they are liable to pay equally as far as their agreed obligation permits.

Discharge of Surety: When the liability of a surety comes to an end, the surety is said to be discharged.

Modes:

- 1) **By Performance:** Where the guaranteed obligation is properly discharged by performance of principal debtor, the obligation of surety with respect to that undertaking is thereby discharge. Performance which releases the principal debtor also discharges the surety.
- 2) **By Variance:** If the creditor and principal debtor vary the terms and conditions of their contract without the consent of surety, the surety is discharged in respect of transaction made after the variation.
- 3) **By Revocation:**
 - a) **By Notice:** A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.
 - b) **By Death:** The death of the surety operates, in the absence of any contract to the contrary, as a revocation of a continuing guarantee, so far as regards future transactions.
- 4) **By Release of Principal Debtor:** The surety is discharged by any contract between the creditor and principal debtor, by which the principal debtor is released.
- 5) **By Act or Omission of Creditor:** The surety is discharged by any act or omission of creditor, the legal consequence of which is the discharge of principal debtor.
- 6) **By Composition:** A contract by which the creditor makes the composition with principal debtor, discharges the surety unless the surety assents to such contract.
- 7) **By Extension of time:** Where a creditor without the consent of surety promises to give time to principal debtor, the surety is discharged.
- 8) **By Promise not to sue:** A contract (without the consent of surety) by which the creditor promises not to sue the principal debtor, discharges the surety.
- 9) **By Impairing surety's remedy:** If the creditor
 - does not act which is in consistent with the rights of the surety,
 - omits to do any act which his duty to the surety requires him to do
and the eventual remedy of the surety himself against the principal debtor is thereby impaired
the surety is discharged.

10) **By Loss of security:** If the creditor:

- loses
 - (without the consent of surety) returns,
- the security which he has against the principal debtor at the time of making of contract of Guarantee,
The surety is discharged to the extent of the value of the security.
This is immaterial whether the surety is or is not aware of the existence of such security.

Discharges of Surety by acts of Creditor:

1. By Variance
2. Be Release
3. By Act or Omission
4. By Composition
5. By Extension of time
6. By Promise not to sue
7. By Impairing surety's remedy
8. By Loss of security

When surety not discharged due to acts of creditor:

- 1) **Agreement with third person:** When a contract to give time to the Principal debtor is made by the creditor with third person and not with the principal debtor, the surety is not discharged.
- 2) **Forbearance to Sue:** Mere forbearance on the part of the creditor to sue the principal debtor discharge the surety unless and until the limitation period for recovery of debt expires.
- 3) **Release of Co-Surety:** When there are co-sureties a release by the creditor of one of them does not discharge the other, neither does it free the surety so released from his responsibility to the other securities.

Difference between Indemnity and Guarantee:

	Indemnity	Guarantee
1) Number of Parties	In indemnity there are two parties i.e. indemnifier and indemnified.	In guarantee, there are three parties i.e. surety, creditor and principal debtor.
2) Number of Contracts	In indemnity there is only one contract between indemnifier and indemnified.	In guarantee, there are three contracts i.e. - between surety and creditor - between surety and principal debtor - an implied contract of indemnity between the principal debtor and surety.
3) Formation	A contract of indemnity may be expressed or Implied.	A contract of guarantee is always be an express contract.
4) Nature of Undertaking	A contract of indemnity is of contingent nature	A contract of guarantee is a collateral contract
5) Nature of Liability	The liability of indemnifier is Primary, Absolute, Total	Here the primary liability is that of principal debtor. The

		liability of surety is secondary and conditional.
6) Commencement of Liability	The liability of indemnifier commences when the indemnified suffer loss	The liability of surety commences when the principal debtor makes default
7) Objective	To save the indemnified from a loss which may occur to him in the future	To provide security to the creditor in respect of existing debts and liabilities
8) Right to sue	Indemnifier cannot sue the third person in his own name but he may initiate the proceedings on behalf of indemnified	On the default of principal debtor, the surety (after discharging his liability) may sue him in his own name.

Guarantee is not a contract of uberrimae fidei: A contract of guarantee is not a contract of uberrimae fidei, i.e., one requiring full disclosure of all material facts by the principal debtor or creditor to the surety before the contract is entered into. Fraud on the part of the principal debtor is not enough to set aside the contract, unless the surety can show that the creditor or his agent knew of the fraud and was a party to it. When a guarantee is given to a banker, there is no obligation on the banker to inform the intending surety of matters affecting the credit of the debtor or any circumstance connected with the transaction which render the position of the surety more hazardous.

If the guarantee is in the nature of insurance, as in a fidelity guarantee, all material facts must be disclosed, otherwise the surety can avoid the contract.