

Contrast between Contract of Indemnity and Gaurantee under Indian Contract Act

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Abstract: *The research paper highlights the distinction between contract of Indemnity and Gaurantee as under Indian Contract Act. The research paper discusses about the rights of the parties under the Contract of Indemnity and Gaurantee. The paper also discusses types of contracts under Indemnity and the two types of Gaurantee in the Contracts of Gaurantee.*

Keywords: Promisor, Promisee, Indemnifier, Indemnity holder, Surety, Creditor, Principal Debtor

1. Introduction

Contract of Indemnity as stated under section 124 of Indian contract act is a contract in which one party promises to save other party from the loss which is caused to him by the conduct of promisor himself or by the conduct of any other person¹. Literal meaning of indemnity is to compensate for the loss incurred or provide protection against loss. Under English law concept of indemnity is based on the principal You must be Damified, before you can be Indemnified which means a person must have suffered a loss or damage before he or she claim any money or compensation. With respect to Contract of Indemnity there is a landmark judgment given in the case of Gajanan Moreshwar v. Moreshwar Madan Mantri². In this case the court said that if the indemnity holder had incurred a liability and that liability is absolute, he is entitled to call upon the indemnifier to save him from that liability and pay it off. The court also said that commencement of liability is not only created when the actual loss is suffered but it is also created where absolute loss is created, thus absolute loss makes it compulsory for the person either to pay the amount in the court or the person can pay the money directly to the third party (indemnity holder) who has suffered a damage. There is another case Adamson v. Jarvis³ regarding Indemnity concept. This is an English law judgment where the court stated that as the plaintiff has acted upon the defendant's request so it was assumed that if the particular act of the defendant turned out wrongful then the plaintiff will be compensated by the defendant. While the Contract of Guarantee as given under section 126 states that A contract of guarantee is a contract which is formed to perform the promise or discharge the obligation of the third party in case of his default⁴. The researcher will also throw some light on an important case of Birkmyr v. Darnell 1709⁵ which deals with the concept of guarantee. This case with regard to the collateral undertaking where a person comes in favour of the person (the principal) and guarantees the lender that if the principal (the person indeed) fails to pay the amount for any reason and makes any kind of default then he (surety) will pay. When we discuss about Indemnity and Guarantee there

are certain concepts which draw sharp contrasts between the two. Contract of indemnity is a contract to indemnify (reimburse) the party who has suffered any loss whereas, contract of guarantee gives assurance to the creditor. In case of contract of indemnity the liability is uncertain (which may or may not arise) but in case of guarantee there already exists a liability which is to be discharged by the principal debtor or the surety. Contract of indemnity and guarantee also draws a clear divergence when it comes to obligation. Contract of Indemnity creates a primary obligation upon the indemnifier or the promisor as the promisor is solely liable for any loss incurred but in case of guarantee creates a secondary obligation upon the surety as the surety is only liable if the principal debtor fails to pay the debt. In contract of indemnity there lies only one contract between the parties but in case of guarantee three contracts are formed between the parties. Besides the criteria discussed above there are various other aspects as well which distinguish Contract of indemnity and guarantee from each other which will be discussed in detail in the later part of paper. Contract of Indemnity and Guarantee both have their own importance in Indian Contract Act and judiciary also plays a very essential role when we discuss about Guarantee and Indemnity. The researcher will also reflect some light on the judicial aspect and various other important concepts relating to indemnity and guarantee in the later part of the research paper.

2. Literature Review

Literature review is one of the main aspects involved in the research paper. The researcher in this paper has reviewed various works from different books, articles, research papers and journals etc. The researcher for an effective and meaningful research has referred to the sections 124 and 126 of Indian Contract Act 1872 which talks about contract of Indemnity and Guarantee. In an article written on indemnity and guarantee the author talks about the detailed concept of indemnity and guarantee and also analyses the difference between them. The author in the article also refers to various case laws for giving a clear and deep understanding of the same⁶. There is another research paper on indemnity and guarantee which the researcher has reviewed for conducting the present research. The author in this research paper has discussed contract of indemnity and guarantee in exhaustive way. The author has discussed the various provisions

¹INDIA CONTRACT ACT, 1872, sec 124

² Gajanan Moreshwar v Moreshwar Madan Mantri AIR 1942 BOM 302

³ Adamson v. Jarvis (1827) 4 Bing 66:29 RR 503

⁴INDIA CONTRACT ACT, 1872, sec 126

⁵Birkmyr v. Darnell 91 ER 27: Salk 27

⁶Saurabh Kumar: *Indemnity and Guarantee – Two sides of the same coin*, Indian National Bar Association, inbatv (2016)

existing in India in case of indemnity as well as guarantee. The author also talked about the essentials of guarantee and has drawn sharp contrasts between the two⁷. The researcher for conducting a valuable research has also referred to books on law of Contracts by Avtar Singh⁸ and Pollock and Mulla⁹ which widely covers the entire concept of the contract of Guarantee and Indemnity and also highlights the difference between the two. This book covers various important sections related to indemnity and guarantee and gives a clear idea to all its readers. The researcher has reviewed all these works for the purpose of conducting a detailed and impressive research.

Research Questions

The current research paper will answer the following questions-

- What is contract of Indemnity and Guarantee?
- What are various essentials of Contract of Indemnity and Guarantee?
- What are the rights and liabilities of parties?

Research Objectives

The objectives of the study are as follows-

- To understand the concept of Indemnity and Guarantee
- To analyse various legal provisions in India regarding Indemnity and Guarantee
- To analyse the judicial arbitration by Indian courts

3. Research Methodology

There are mainly two types of research methodologies namely Doctrinal and Non-Doctrinal used for conducting research work. Doctrinal method of research mainly emphasis on conducting research by analysing the material available i. e. the primary sources of data; statutes, acts, laws, rules and regulations or the secondary sources of data i. e. published articles, journals, research papers and newspapers etc. while non-doctrinal research requires the researchers to undergo field work for the purpose of research. The current research topic demands doctrinal method of research for the purpose of conducting effective research and to study and understand the entire concept of Indemnity and Guarantee in depth and thus to provide greater knowledge and understanding to the readers as well.

4. Types of Guarantee and Indemnity

4.1 Under Contract Of Indemnity

There are two types of contracts Implied Contract and Express Contract

4.1.1 Implied Contracts: The contracts which are formed either out of the relation between the parties for example-employer and employee or principal-Agent or which are

applied by statutes or existing laws for example-Partnership Act such contracts are called implied contracts.

Judicial Interpretation by Law

Case Law-Secretary of State for India v Bank of India¹⁰

In this case the court said that the secretary of state will act as an indemnity holder and the bank will act as the indemnifier and if the real owner claim the damages then it is the bank of India who will pay for those damages because there was an implied promise between the bank of India and the secretary that all the activities will be done following a particular procedure and if it is not done following the procedure then it is the responsibility of the bank to indemnify the secretary of the state.

4.1.2 Express Contracts: The contracts which either in oral or written form are termed as express contracts. In simple words the contracts for which the parties give their consent either in writing or through words are known as express contracts

4.2 Contract of Guarantee

There are two types of guarantee Specific Guarantee and Continuing Guarantee

4.2.1 Specific Guarantee (One Time Guarantee)- Guarantee which is given for one particular transaction is called specific guarantee.

4.2.2 Continuing Guarantee- Guarantee which is given for multiple transactions or a series of transactions is called continuing guarantee.

5. Parties to Contract

5.1 Under Contract of Indemnity

There are two parties to contract i) Indemnifier and ii) Indemnity holder –

- a) Promisor / Indemnifier-is the person who promises to bear the loss
- b) Promisee / Indemnity Holder-is the person who suffers a loss and to whom the compensation is made.

5.2 Under Contract of Guarantee

There are three parties to contract i) Principal Debtor, ii) Surety and iii) Creditor

- a) Principal Debtor-is the person primarily liable to pay the debt and on whose behalf the guarantee is given.
- b) Surety-is the person who gives the guarantee
- c) Creditor-is the person to whom the guarantee is given.

6. Rights of Parties

6.1 Under Contract of Indemnity

6.1.1 Rights of Indemnity Holder

- a) **DAMAGES-**As per Section 25 (1) of Indian Contract Act¹¹ the indemnity holder has the right to recover all

⁷ Contract Of Indemnity And Guarantee, 1 Burnished Law Journal (2020)

⁸ Avtar Singh, Contract & Specific Relief (Eastern Book Company 2020)

⁹ 1, Pollock & Mulla, The Indian Contract Act, 1872 (Lexis Nexis 2018)

¹⁰ Secretary of State for India v Bank of India AIR[1938] PC 191

the amount from the indemnifier which he was forced to pay in a court case in the respect of the matter for which the promise was made, provided he acted as a ordinary prudent person and has acted under the authority of the promisor.

- b) **COSTS**-As per Section 25 (2) of Indian Contract Act¹² the indemnity holder also has the right to recover all costs from the indemnifier which he has incurred while filing a court case or in defending the same, provided he acted as a ordinary prudent person in absence of any contract or as authorised by the promisor.
- c) **SUMS**-As per Section 25 (3) of Indian Contract Act¹³ the indemnity holder also has the right to recover all sums from the indemnifier which he has paid under any kind of compromise which he has made under any court case provided the compromise is made as per the terms laid by the promisor and the promisee has acted as an ordinary prudent person in absence of any contract or as authorised by the promisor.

6.1.2 Rights of Indemnifier

Unlike the rights of the indemnity holder the rights of Indemnifier are not expressly mentioned under Indian Contract Act 1872.

Judicial Interpretation By Law

Maharana Shri Jaswant Singh Fateh v. Sect of State

In this case the Court said that the rights of the indemnifier are similar to the rights of a surety. Rights of a surety are given under Section 141 of Indian Contract Act. The indemnifier, upon indemnification, will be entitled to all the protection which the indemnity holder was entitled to. The principle of subrogation also comes into existence. The principle of subrogation follows the principle of substitution. Once the promisor pays the amount of compensation, he replaces the indemnity holder.

6.2 Under Contract of Guarantee

Rights of a Surety

6.2.1 Against the Principal Debtor

- a) **Right of Subrogation**— Subrogation means substitution; once the surety pays the amount to the creditor he himself steps in the shoes of the creditor.
- b) **Right of Indemnity**-Section 145 of the Contract Act¹⁴ says that in guarantee there is always an implied promise by the principal to the surety and the surety is liable to recover all amount from principal debtor which he has paid rightfully under guarantee but he cannot claim an amount which is wrongfully paid.

3.2.2 Rights against Creditor

- a) **Right to securities**-As per Section 141 of Indian Contract Act¹⁵ the surety has a right over every security of the principal debtor which the creditor has with him at the time of entering in the contract of suretyship

irrespective of the fact that surety is aware about that security being given or not and if the creditor in any case tends to sell of the security or loses the security or any haram is caused to the same the surety is discharged from its liability till the extent of value of that security.

- b) **Right to set-off**-In certain cases principal debtor is entitled to a counter claim or some deductions from the loan taken from the creditor. in such cases the surety is entitled to the same claim or deductions which are being made, if the creditor files a case against surety.

6.2.3 Rights against Co-Sureties

- a) **Effect of releasing a surety**-Section 138 of the Indian Contract Act 1872¹⁶, says that in case of co-sureties the release of any one of them from of the co-surety from the liability by the creditor does not discharge all other sureties as well and neither does this releases the surety from his responsibility towards other sureties.

6.2.4 Right to contribution

- a) **Co-sureties liable to contribute equally**-Section 146 of Indian Contract Act¹⁷ says that when there are two or more Co-sureties on one particular debt either joint or several and may be under same contract or different contract and may be with or without the knowledge of the same to the other sureties and in absence of any other contract are liable to pay the debt equally to the principal.
- b) **Liabilities of co-sureties bound in different levels**-Section 147 of the Contract Act¹⁸ says that co-sureties who are liable to pay the debt in different amount are bound to pay the amount equally till the time the limits of their obligations permit them to do so.

7. Number of Contracts

7.1.1 Under Contract Of Indemnity

Under Indemnity there is only one contract which is formed by the parties i. e. the contract between the indemnifier and indemnity holder which is known as the indemnity Contract.

7.1.2 Under Contract of Guarantee

Under guarantee there are three contracts which are formed; one is the contract between the creditor and the principal debtor, other one is the contract between creditor and surety and the third one is the contract between surety and principal debtor. the contract which is formed between surety and the creditor is termed as the contract of guarantee.

8. Conclusion and Suggestions

Contract of Indemnity and Guarantee are interrelated topics yet there is a deep contract which has been drawn between the two in the entire research paper. The researcher after undertaking a detailed study and conducting a research on the same it is understood that although there lies a sharp contrast between indemnity and guarantee but at the same time they are also similar in some ways, in both indemnity and guarantee the person that is either the indemnifier or the surety has to indemnify and in any of the parties cannot take

¹¹INDIAN CONTRACT ACT, 1872 sec 125, cl.1

¹²INDIAN CONTRACT ACT, 1872 sec 125, cl. 2

¹³INDIAN CONTRACT ACT, 1872 sec 125, cl. 3

¹⁴INDIAN CONTRACT ACT, 1872 sec 145

¹⁵INDIAN CONTRACT ACT, 1872 sec 141

¹⁶INDIAN CONTRACT ACT, 1872 sec 138

¹⁷INDIAN CONTRACT ACT, 1872 sec 146

¹⁸INDIAN CONTRACT ACT, 1872 sec 147

undue advantage of the provisions available to them and other main essential is that the whichever contract is formed by parties must fulfil all the essentials of a valid contract mentioned under section 1 to 75 of the Indian Contract Act, 1872 i. e. contract which is formed should be made with the free consent of parties, there must be some lawful object and lawful consideration and the contract which is formed by the should not be influenced by coercion, misrepresentation, undue influence etc. The researcher has highlighted these points just give a clear and better vision and understanding of the same to its readers.

References

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- [14] INDIAN CONTRACT ACT, 1872 sec 141
- [15] INDIAN CONTRACT ACT, 1872 sec 138
- [16] INDIAN CONTRACT ACT, 1872 sec 146
- [17] INDIAN CONTRACT ACT, 1872 sec 147