Indemnity

S. 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".

The person who gives the indemnity is called the "indemnifier" and the person for whose protection it is given is called the "indemnity-holder" or "indemnified".

Thus the scope of "indemnity" is by the very process of definition restricted to cases where there is a promise to indemnify against loss, caused: (*a*) by the promisor himself, or (*b*) by any other person. The definition excludes from its purview cases of loss arising from accidents like fire or perils of the sea. Loss must be caused by some human agency.

S. 125. Rights 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 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 such 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.

Commencement of liability- In order to be indemnified you must be damnified first.

But latter it has been accepted both in England and India that

"Indemnity is not necessarily given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called upon to pay … .

See e.g. Gajanan Moreshwar Parelkar* v *Moreshwar Madan Mantri (Bom. HC)

Guarantee

S. 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.

A Tripartite Agreement: Parties Involved- Creditor, Principal debtor and Guarantor or Surety.

Can be written or Oral.

Example: "If two come to a shop and one buys, and the other to give him credit, promises the seller, 'If he does not pay you, I will'."

> Independent liability different from guarantee: A landlord and his tenant went to the plaintiff's store. The landlord said to the plaintiff: Mr Parker will be on our land this year, and you will sell him anything he wants, and I will see it paid.
>
> This was held to be an original promise, and not a collateral promise to be liable for the default of another and, therefore, not a guarantee.

Principal Debt- A Recoverable Debt Necessary: The Foundation of Surety's liability is Principal Debtor's liability, if that foundation is gone the surety is not liable.

Minor's Debt and Surety's liability- *Edaven Kavungal Kellapan v Moolakal Kunhi Raman and Ors.* AIR 1957 Mad. 164.

If the fact of infancy is known to all the parties and the intention was to give the debt to the minor the surety is not liable.

S. 128. **Surety's liability**. — The liability of the surety is co-extensive with that of the principal debtor, unless it is otherwise provided by the contract.

Thus not liable only for the principal amount but the interest also unless there is a contract to the contrary.

Proceeding against surety without exhausting remedies against debtor

Where the liability is otherwise unconditional, the court cannot of its own introduce a condition into it. This was pointed out by the Supreme Court in ***Bank of Bihar Ltd*** **v** ***Damodar Prasad***.

> The defendant guaranteed a bank's loan. A default having taken place, the defendant was sued. The trial court decreed that the bank shall enforce the guarantee in question only after having exhausted its remedies against the principal debtor. The Patna High Court confirmed the decree. But the Supreme Court overruled it.

Explaining that a condition of this kind would defeat the parties' intention, the court said: "The very object of the guarantee is defeated if the creditor is asked to postpone his remedies against the surety. Is the creditor to ask for imprisonment of the principal? Is he bound to discover at his peril all the properties of the principal and sell them; if he cannot, does he lose his remedy against the surety? Has he to file an insolvency petition against the principal? The trial court gave no reason for this extraordinary direction. It said that the principal was solvent. But the solvency of the principal is not a sufficient ground for restraining execution of the decree against the surety. It is the duty of the surety to pay the decretal amount. On such payment he will be subrogated to the rights of the creditors."

And as so subrogated may exhaust his remedies against the creditor. "Before payment the surety has no right to dictate terms to the creditor and ask him to pursue his remedies against the principal in the first instance. The surety is a guarantor; and it is his business to see that the principal pays, and not that of the creditor."

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

Example- Bank Overdraft facility

A guarantee of this kind is intended to cover a number of transactions over a period of time. The surety undertakes to be answerable to the creditor for his dealings with the debtor for a certain time. A guarantee for a single specific transaction comes to an end as soon as the liability under that transaction ends.

The employment of a person is one transaction and the guarantee for his good conduct is not a continuing guarantee.

Discharge of Surety from Liability

By revocation [S. 130]- Only a continuing Guarantee can be revoked.

S. 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.

The employment of a servant is one transaction. A guarantee for his good behaviour is not a continuing one and is not revocable as long as he continues in the job.

By death of surety [S. 131]

A continuing guarantee is also determined by the death of the surety unless there is a contract to the contrary. Once again, the termination becomes effective only for the future transactions. The surety's heirs can be sued for liability already incurred. The section clearly points this out.

S. 133. **Discharge of surety by variance in terms of contract**.—Any variance, made without the surety's consent, in the terms of the contract between the principal [debtor] and the creditor, discharges the surety as to transactions subsequent to the variance.

One of the questions that concerns the courts is that where a variation is not substantial or material, or is beneficial to the surety, will he be discharged? A problem of this kind was before the Supreme Court in ***M.S. Anirudhan* v *Thomco's Bank Ltd.***

The defendant guaranteed the repayment of a loan of Rs 20,000 given by the plaintiff bank to the principal debtor. The guarantee paper showed the loan to be Rs 25,000. The bank refused to accept. The principal then reduced the amount to Rs 20,000 and without intimation to the surety gave it to the bank which was then accepted. The principal debtor failed to pay and the bank sued the surety. The question was whether the alteration had discharged him.

Strict Rule applied in in *Blest* v *Brown* that any varience would discharge the surety since he can say that it's not the contract I had consented to.

The Court of Appeal in *Holme* v *Brunskill.*

"The true rule in my opinion is that if there is any agreement between the principals with reference to the contract guaranteed, the surety ought to be consulted, and that if he has not consented to the alteration, although in cases where it is without inquiry evident that the alteration is unsubstantial, or that it cannot be otherwise than beneficial to the surety, the surety may not be discharged; yet that if it is not self-evident that the alteration is unsubstantial or one which cannot be prejudicial to the surety, the court will not in an action against the surety, go into inquiry as to the effect of the alteration."

S. 134. **Discharge of surety by release or discharge of principal debtor**. — The surety is discharged by any contract between the creditor and the principal debtor, by which the principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

Illustrations

(*a*) *A* gives a guarantee to *C* for goods to be supplied by *C* to *B*. *C* supplies goods to *B*, and afterwards *B* becomes embarrassed and contracts with his creditors (including *C*'s to assign to them his property in consideration of their releasing him from their demands). Here *B* is released from his debt by the contract with *C*, and *A* is discharged from his suretyship.

(*b*) *A* contracts with *B* to grow a crop of indigo on *A*'s land and to deliver it to *B* at a fixed rate, and *C* guarantees *A*'s performance of this contract. *B* diverts a stream of water which is necessary for irrigation of *A*'s land and thereby prevents him from raising the indigo. *C* is no longer liable on his guarantee.

(*c*) *A* contracts with *B* for a fixed price to build a house for *B* within a stipulated time, *B* supplying the necessary timber. *C* guarantees *A*'s performance of the contract. *B* omits to supply the timber. *C* is discharged from his suretyship.

U/S 134, 2 situations are contemplated w.r.t the release of the Surety on account of the release of the Principal Debtor (i) By a compromise (ii) an act or omission on the part of the creditor.

S. 135. Discharge of surety when creditor compounds with, gives time to, or agrees not to sue principal debtor. — A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue the principal debtor, discharges the surety, unless the surety assents to such contract.

The section provides for three modes of discharge from liability:

(1) **Composition;** If the creditor makes a composition with the principal debtor, without consulting the surety, the latter is discharged. Composition inevitably involves variation of the original contract, and, therefore, the surety is discharged.
A compromise in terms of a court decree is different from private composition. That does not discharge the surety, unless the decree is collusive

(2) **Promise to give time, and**

(3) Promise not to sue the principal debtor.

When the time for the payment of the guaranteed debt comes, the surety has the right to require the principal debtor to pay off the debt. Accordingly, it is one of the duties of the creditor towards the surety not to allow the principal debtor more time for payment. "The creditor has no right, it is against the faith of his contract, to give time to the principal, even though manifestly for the benefit of the surety, without the consent of the surety."

S. 136. Surety not discharged when agreement made with third per-son to give time to principal debtor. — Where a contract to give time to the principal debtor is made by the creditor with a third person, and not with the principal debtor, the surety is not discharged.

S. 137. Creditor's forbearance to sue does not discharge surety. — Mere forbearance on the part of the creditor to sue the principal debtor or to enforce any other remedy against him does not, in the absence of any provision in the guarantee to the contrary, discharge the surety.

Mahant Singh v *U Ba Yi.* Lord PORTER observed as follows: " … a failure to sue the principal debtor until recovery is barred by the statutes of limitation does not operate as a discharge of the surety

Limitation: In SYNDICATE BANK v. CHANNAVEERAPPA BELERI AND OTHERS the Supreme Court SC 2006 held that the limitation as to guarantor's liability depends on the terms and conditions of contract and limitation starts running only when actually a demand for payment is made and it was refused by guarantors, however, such a demand should not be time-barred against the principal debtor i.e. it should be a live claim against the PD.

A claim may be even time-barred against the principal debtor, but still enforceable against the guarantor. The parties may agree that the liability of a guarantor shall arise at a later point of time than that of the principal debtor. The question as to when the liability of a guarantor will arise, would depend purely on the terms of the contract.

If Demand is to be made then once demand is made and the period mentioned is over. And if no period is mention then time would start to run from the moment the notice is served.

For Bank Guarantee See Section 28 exception III – time period can be reduced to one year.

S. 139. Discharge of surety by creditor's act or omission impairing surety's eventual remedy.—If the creditor does any act which is inconsistent with the right of the surety, or 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.
It is the plain duty of the creditor not to do anything inconsistent with the rights of the surety.

If the creditor does any act which is inconsistent with the rights of the surety, or 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 impaired, the surety is discharged.

Bhabani Shankar Patra v SBI AIR 1986 Orissa HC.

The main contention raised by the appellant in this appeal is that he has been absolved from the liability, if any, as a guarantor with effect from 8-8-1972, the date of Ext. 11, when he had intimated the Bank that defendant 1, the borrower, is making brisk attempts to sell away the entire stock of goods in order to escape his liability and that the Bank should waste no time to take all possible steps for recovery of the dues from him. According to him, the Bank was guilty of taking no action against defendant 1 which, he alleges to be, in pursuance of a connivance between the Bank and defendant No. 1.

The Court held that the surety is not discharged.

Rights of surety- (1) Against the Principal Debtor (2) Against the Creditor

Against the Principal Debtor- Following are the rights of the surety against the principal debtor:

1. Right of Subrogation [S. 140]
2. Right to Indemnity [S. 145]

Right of Subrogation [S. 140]

S. 140. Rights of surety on payment or performance.—Where a guaranteed debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor.

> **Rights before payment and after payment:** "It has been stated there that the surety has an equitable right to compel the principal debtor to pay the debt and so relieve the surety from the necessity of paying it out of his pocket. It is in the nature of *quia timet*, and is based on the principle that it is unreasonable that a man should always have a cloud hang over him, so that he ought to be entitled to remove it. It is, therefore, immaterial that the creditor has refused to sue or that he has made no demand. *A fortiori*, the action lies where the principal debtor threatens to commit a breach of the obligations which the surety has guaranteed and an order may be made even though the principal debtor is without funds.

The Calcutta High Court examined this possibility in a ***Mamata Ghose* v *United Industrial Bank Ltd*, AIR 1987 Cal 280,** where the surety found, that the amount having become due, the principal debtor was disposing of his personal properties one after the other lest the surety, after paying, may seize them and sought a temporary injunction to prevent the principal debtor from doing so. The court granted the injunction.

S. 145. **Implied promise to indemnify surety**. — In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety; and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully.

B indebted to *C*, and *A* is surety for the debt. *C* demands payment from *A*, and on his refusal sues him for the amount. *A* defends the suit, having reasonable grounds for doing so, but is compelled to pay the amount of the debt with costs. He can recover from *B* the amount paid by him for costs, as well as the principal debt.

(*b*) *C* lends *B* a sum of money, and *A*, at the request of *B*, accepts a bill of exchange drawn by *B* upon *A* to secure the amount. *C*, the holder of the bill, demands payment of it from *A*, and, on *A*'s refusal to pay, sues him upon the bill. *A*, not having reasonable grounds for so doing, defends the suit, and has to pay the amount of the bill and costs. He can recover from *B* the amount of the bill, but not the sum paid for costs, as there was no real ground for defending the action.

(*c*) *A* guarantees to *C*, to the extent of 2000 rupees, payment for rice to be supplied by *C* to *B*. *C* supplies to *B* rice to a less amount than 2000 rupees, but obtains from *A* payment of the sum of 2000 rupees in respect of the rice supplied. *A* cannot recover from *B* more than the price of the rice actually supplied.

Rights against creditor

The surety enjoys the following rights against the creditor:

1. Right to securities [S. 141]
2. Right to share reduction
3. Right of set off

S. 141. **Surety's right to benefit of creditor's securities**. — A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without the consent of the surety, parts, with such security, the surety is discharged to the extent of the value of the security.

State of M.P.* v *Kaluram. **AIR 1967 SC 1105**

The State sold a lot of felled timber to a person for a fixed price payable in four equal instalments, the payment of which was guaranteed by the defendant. The contract further provided that if a default was made in the payment of an instalment, the State would get the right to prevent further removal of the timber and to sell the remaining timber for the realisation of the price. The buyer defaulted but even so the State allowed him to remove the timber.

The surety was then sued for the loss. But he was held not liable. “The State had a charge over the goods sold as well as to remain in possession till payment of the instalments. When the goods were removed by the buyer that security was lost and to the extent of the value of the security lost, the surety stood discharged.” The court also pointed out that it was immaterial that the loss of securities was due to a mere inaction and not to a positive action.