CHAPTER 1

THE INDIAN CONTRACT ACT, 1872

UNIT–1 : CONTRACT OF INDEMNITY AND GUARANTEE

LEARNING OUTCOMES

After studying this unit, you would be able to :

- Identify special type of contracts i.e. Indemnity contracts and Guarantee contracts and also the nature of obligations and rights of each of the parties to the contracts.
- Explain distinction between these contracts.

UNIT OVERVIEW

- Contracts of Indemnity and Guarantee (Section 124-147)
  - Contract of Indemnity (Section 124-125)
  - Contract of Guarantee (Section 126-127)
  - Nature of Surety s Liability (Section 128)
  - Continuing Guarantee (Section 129-132)
  - Discharge of Surety (Section 133-139)
  - Rights of Surety (Section 140-147)

1. INTRODUCTION

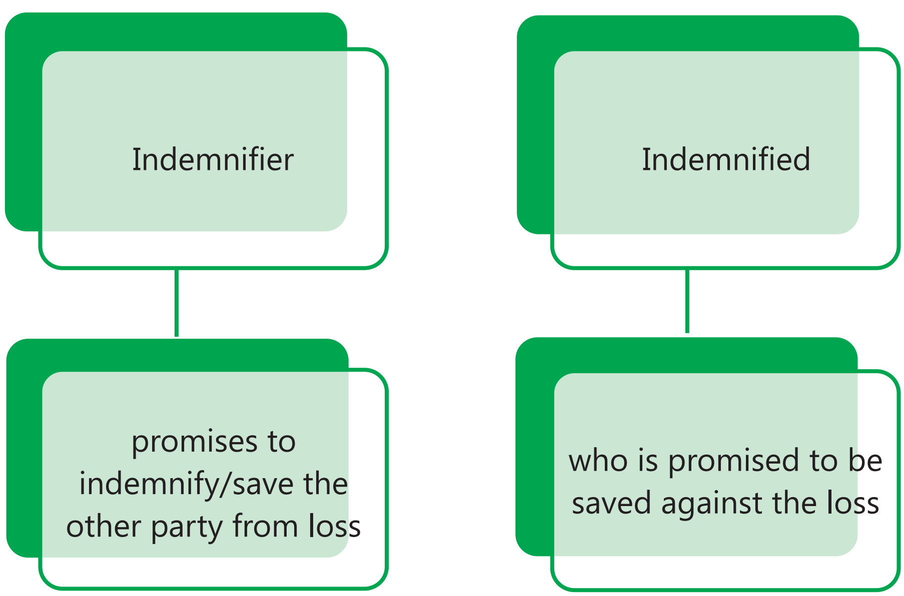
Contract of Indemnity and Guarantee are the special types of contracts given under sections 124 to 147 of the Indian Contract Act, 1872. Both the contracts are modes of compensation based on certain similar principles. However, both differs from each other on several issues.

In this unit, the law relating to indemnity and guarantee are discussed.

2. CONTRACT OF INDEMNITY

"Contract of Indemnity" defined (Section 124) : 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."

There are two parties in this form of contract. The party who promises to indemnify/ save the other party from loss is known as **'indemnifier'**, where as the party who is promised to be saved against the loss is known as **'indemnified' or indemnity holder.**



Example 1 : A may contract to indemnify B against the consequences of any proceedings which C may take against B in respect of a sum of ` 5000/- advanced by C to B. In consequence, when B who is called upon to pay the sum of money to C fails to do so, C would be able to recover the amount from A as provided in Section 124.

Example 2 : X, a shareholder of a company lost his share certificate. He applied for the duplicate. The company agreed to issue the same on the term that X will compensate the company against the loss where any holder produces the original certificate. Here, there is contract of indemnity between X and the company.

Analysis

To indemnify means to compensate or make good the loss. Thus, under a contract of indemnity the "existence of loss" is essential. Unless the promisee has suffered a loss, he cannot hold the promisor liable on the contract of indemnity.

However, the above definition of indemnity restricts the scope of contracts of indemnity in as much as it covers only the loss caused :

(i) By the conduct of the promisor himself, or

(ii) By the conduct of any other person.

Thus, loss occasioned by the conduct of the promise, or accident, or an act of God is not covered.

A contract of indemnity like any other contract may be express or implied.

A contract of indemnity is like any other contract and must fulfill all the essentials of a valid contract like consideration, free consent, competency of contract, lawful object etc.

Example : A asks B to beat C promising to indemnify him against the consequences. The promise of A cannot be enforced. Suppose, B beats C and is fined Rs. 1000, B cannot claim this amount from A because the object of the agreement is unlawful.

A contract of Fire Insurance or Marine Insurance is always a contract of indemnity. But there is no contract of indemnity in case of contract of Life Insurance.

Rights of Indemnity—holder when sued (Section 125) : The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor/indemnifier—

(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 authorised him to compromise the suit.

Analysis :

In a contract of indemnity, the promisee i.e., indemnity- holder acting within the scope of his authority is entitled to recover from the promisor i.e., indemnifier the following rights :

(a) all damages which he may be compelled to pay in any suit
(b) all costs which he may have been compelled to pay in bringing/ defending the suit and
(c) all sums which he may have paid under the terms of any compromise of suit.

It may be understood that the rights contemplated under section 125 are not exhaustive. The indemnity holder/ indemnified has other rights besides those mentioned above. If he has incurred a liability and that liability is absolute, he is entitled to call upon his indemnifier to save him from the liability and to pay it off.

Please note that the Indian Contract Act is silent about the rights which the Indemnifier has on carrying out his promise to indemnify. But they are similar to the rights of a surety under section 141 of the Indian Contract Act.

3. CONTRACT OF GUARANTEE

Contract of guarantee", "surety", "principal debtor" and "creditor" [Section 126]

Contract of guarantee : A contract of guarantee is a contract to perform the promise made or discharge the liability, of a third person in case of his default.

Three parties are involved in a contract of guarantee	**Surety-** person who gives the guarantee,
	Principal debtor- person in respect of whose default the guarantee is given,
	Creditor-person to whom the guarantee is given

Example 1 : When A requests B to lend ₹ 10,000 to C and guarantees that C will repay the amount within the agreed time and that on C falling to do so, he will himself pay to B, there is a contract of guarantee.

Here, B is the creditor, C the principal debtor and A the surety.

Example 2 : Where 'A' obtains housing loan from LIC Housing and if 'B' promises to pay LIC Housing in the event of 'A' failing to repay, it is a contract of guarantee.

Example 3 : X and Y go into a car showroom where X says to the dealer to supply latest model of Wagon R to Y. In case of Y's failure to pay, X will be paying for it. This is a contract of guarantee because X promises to discharge the liability of Y in case of his defaults.

Analysis

Guarantee is a promise to pay a debt owed by a third person in case the latter does not pay.

Any guarantee given may be oral or written.

From the above definition, it is clear that in a contract of guarantee there are, in effect three contracts

(i) A principal contract between the principal debtor and the creditor

(ii) A secondary contract between the creditor ad the surety.

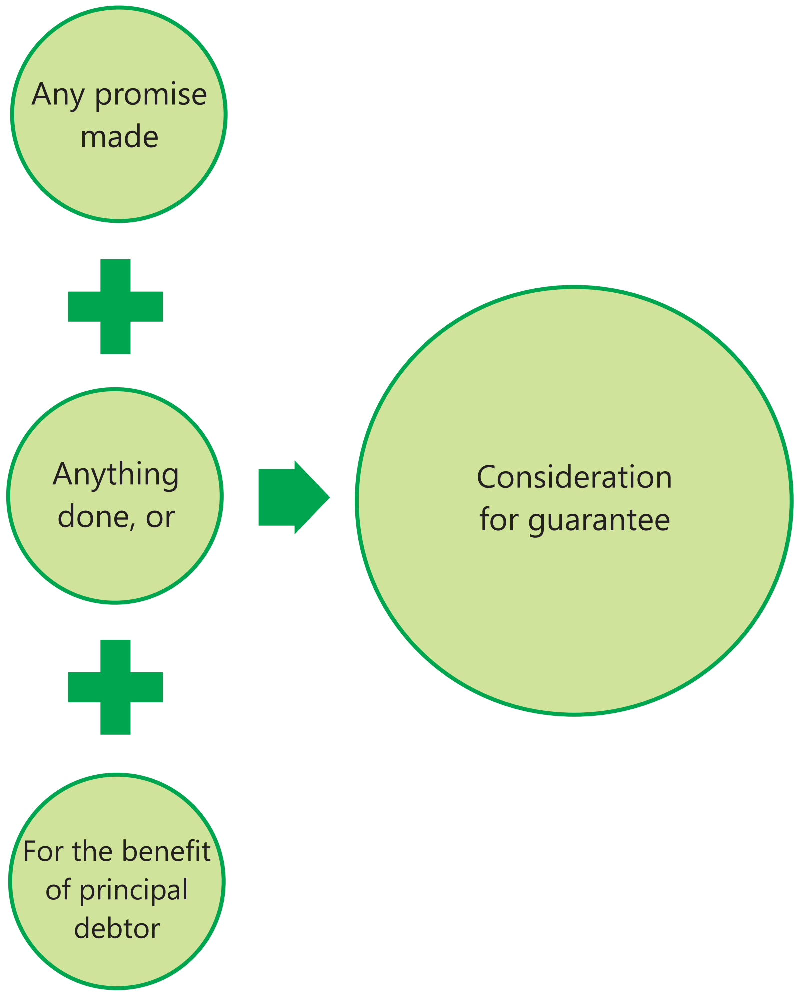
(iii) A implied contract between the surety and the principal debtor whereby principal debtor is under an obligation to indemnify the surety; if the surety is made to pay or perform.

The right of surety is not affected by the fact that the creditor has refused to sue the principal debtor or that he has not demanded the sum due from him.

Consideration for guarantee [Section 127] : What constitutes consideration in a case of guarantee is an important issue and is laid down in Section 127 of the Act. As per Section 127 of the Act, "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."

Example 1 : B requests 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.

Example 2 : A sell 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.



Example 3 : A sells and delivers goods to B. C afterwards, without consideration, agrees to pay for them in default of B. The agreement is void.

Essentials of a valid Guarantee

1. Existence of a principal debt.
2. Benefit to principal debtor is sufficient consideration, but past consideration is no consideration for a contract of guarantee.
3. Consent of surety should not be obtained by misrepresentation or concealment of a material fact.
4. Can be oral or written.
5. Surety can proceeded against without proceeding against the principal debtor first.
6. If the co-surety does not join, the contract of guarantee is not valid.

4. DISTINCTION BETWEEN A CONTRACT OF INDEMNITY AND A CONTRACT OF GUARANTEE

Point of distinction	Contract of Indemnity	Contract of Guarantee
Number of parties/ Parties to the contract	there are only two parties namely the indemnifier [promisor] and the indemnified [promisee]	there are three parties creditor, principal debtor and surety.
Nature of liability	The liability of the indemnifier is primary and independent	The liability of the surety is secondary as the primary liability is that of the principal debtor.
Time of liability	The liability of the indemnifier arises only on the happening of a contingency.	Liability is already in existence but specifically crystallizes when principal debtor fails.
Time to Act	The indemnifier need not necessarily act at the request of indemnified	surety must act by extending guarantee at the request of debtor
Right to sue third party	indemnifier cannot sue a third party for loss in his own name as there is no privity of contract. Such a right would arise only if there is an assignment in his favour.	surety can proceed against principal debtor in his own right because he gets all the right of a creditor after discharging the debts.
Purpose	Reimbursement of loss	For the security of the creditor
Competency to contract	All parties must be competent to contract	In the case of a contract of guarantee, where a minor is a principal debtor, the contract is still valid.
Number of Contracts	Only one original and independent contract between indemnifier and indemnified.	There are 3 contracts made between– ● Creditor and principal debtor ● Creditor and Surety ● Surety and Principal debtor

5. NATURE OF SURETY'S LIABILITY [SECTION 128]

The liability of the surety is co-extensive with that of the principal debtor unless it is otherwise provided by the contract.

Analysis :

(i) The term "co-extensive with that of principal debtor" means that the surety is liable for what the principal debtor is liable.

(ii) The liability of a surety arises only on default by the principal debtor. But as soon as the principal debtor defaults, the liability of the surety begins and runs co-extensive with the liability of the principal debtor, in the sense that the surety will be liable for all those sums for which the principal debtor is liable.

(iii) Where a debtor cannot be held liable on account of any defect in the document, the liability of the surety also ceases.

(iv) Surety's liability continues even if the principal debtor has not been sued or is omitted from being sued. In other words, a creditor may choose to proceed against a surety first, unless there is an agreement to the contrary.

Example : 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.

Nature of Surety's liability can be summed up as (a) Liability of surety is of secondary nature as he is liable only on default of principal debtor. (b) his liability arises immediately on the default by the principal debtor (c) The Creditor has a right to sue the surety directly without first proceeding against principal debtor.

6. CONTINUING GUARANTEE

Continuing guarantee (Section 129): A guarantee which extends to a series of transactions is called a "continuing guarantee". The essence of continuing guarantee is that it applies not to a specific number of transactions but to any number of transactions and makes the surety liable for the unpaid balance at the end of the guarantee.

Example 1 : A, in consideration that B will employ C in collecting the rents of B's zamindari, promises B to be responsible, to the amount of Rs. 5,000 rupees, for due collection and payment by C of those rents. This is a continuing guarantee.

Example 2 : A guarantees payment to B, a tea-dealer, to the amount of $ 100, for any tea he may from time to time supply to C. B supplies C with tea to above the value of $ 100, and C pays B for it. Afterwards B supplies C with tea to the value of $ 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 $100.

Example 3 : 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.

In the continuing guarantee, the liability of surety continues till the performance or the discharge of all the transactions entered into or the guarantee is withdrawn.

7. LIABILITY OF TWO PERSONS, PRIMARILY LIABLE, NOT AFFECTED BY ARRANGEMENT BETWEEN THEM THAT ONE SHALL BE SURETY ON OTHER'S DEFAULT.

Where two persons contract with a third person to undertake a certain liability, and also contract with each other that one of them shall be liable only on the default of the other, the third person not being a party to such contract, the liability of each of such two persons to the third person under the first contract is not affected by the existence of the second contract, although such third person may have been aware of its existence. (Section 132)

Example : A and B make a joint and several promissory note to C. A makes it, in fact, as surety for B, and C knows this at the time when the note is made. The fact that A, to the knowledge of C, made the note as surety for B, is no answer to a suit by C against A upon the note.

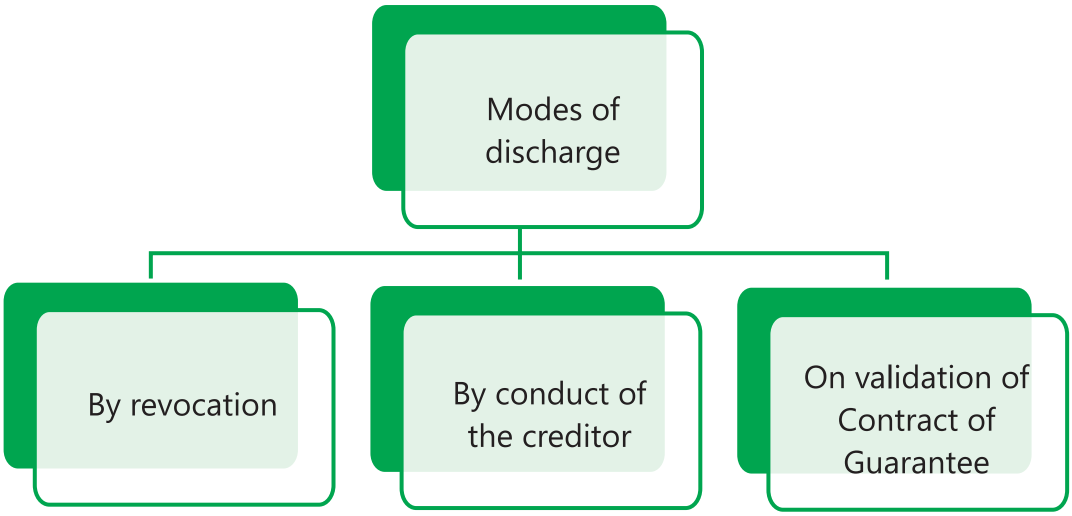
8. DISCHARGE OF A SURETY

A surety is discharged from liability on a guarantee under the following circumstances :

(i) By revocation of the contract of guarantee

(ii) By the conduct of the creditor, or

(iii) By the invalidation of the contract of guarantee.



By revocation of the Contract of Guarantee

(a) **Revocation of continuing guarantee (Section 130) :** The continuing guarantee may at any time be revoked by the surety as to future transactions by notice to the creditors.

Example 1 : 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 50,000 rupees. B discounts bills for C to the extent of 20,000 rupees. Afterwards, at the end of three months, A revokes the guarantee. This revocation discharges A from all liability to B for any subsequent discount. But A is liable to B for the 20,000 rupees, on default of C.

Example 2 : A guarantees to B, to the extent of 100,000 rupees, that C shall pay all the bills that B shall draw upon him. B draws upon C. C accepts the bill. A gives notice of revocation. C dishonours the bill at maturity. A is liable upon his guarantee.

(b) Revocation of continuing guarantee by surety's death (Section 131) : 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.

The estate of deceased surety is, however, liable for those transactions which had already taken place during the lifetime of the deceased. Surety's estate will not be liable for the transactions taking place after the death of surety even if the creditor had no knowledge of surety's death.

By conduct of the creditor

(a) By variance in terms of contract (Section 133) : Where there is any variance in the terms of contract between the principal debtor and creditor without surety's consent, it would discharge the surety in respect of all transactions taking place subsequent to such variance.

Example 1 : A becomes surety to C for B's conduct as a manager in C's bank. Afterwards, B and C contract, without A's consent, that B's salary shall be raised, and that he shall become liable for one-fourth of the losses on overdrafts. B allows a customer to overdraw, and the bank loses a sum of money. A is discharged from his suretyship by the variance made without his consent, and is not liable to make good this loss.

Example 2 : A guarantees C against the misconduct of B in an office to which B is appointed by C, and of which the duties are defined by an Act of the Legislature. By a subsequent Act, the nature of the office is materially altered. Afterwards, B misconducts himself. A is discharged by the change from future liability under his guarantee, though the misconduct of B is in respect of a duty not affected by the later Act.

Example 3 : C agrees to appoint B as his clerk to sell goods at a yearly salary, upon A's becoming surety to C for B's duly accounting for moneys received by him as such clerk. Afterwards, without A's knowledge or consent, C and B agree that B should be paid by a commission on the goods sold by him and not by a fixed salary. A is not liable for subsequent misconduct of B.

Example 4 : A gives to C a continuing guarantee to the extent of 3,00,000 rupees for any oil supplied by C to B on credit. Afterwards B becomes embarrassed, and, without the knowledge of A, B and C contract that C shall continue to supply B with oil for ready money, and that the payments shall be applied to the then existing debts between B and C. A is not liable on his guarantee for any goods supplied after this new arrangement.

Example 5 : C contracts to lend B 5,00,000 rupees on the 1st March. A guarantees repayment. C pays the 5,00,000 rupees to B on the 1st January. A is discharged from his liability, as the contract has been varied, in as much as C might sue B for the money before the 1st March.

(b) By release or discharge of principal debtor (Section 134) : 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.

Example : 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.

(c) **Discharge of surety when creditor compounds with, gives time to, or agrees not to sue, principal debtor [Sector 135] :** 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.

(d) **Surety not discharged when agreement made with third person to give time to principal debtor [Section 136] :** 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.

Example : C, the holder of an overdue bill of exchange drawn by A as surety for B, and accepted by B, contracts with M to give time to B. A is not discharged.

(e) **Creditor's forbearance to sue does not discharge surety [Section 137] :** 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.

Example : B owes to C a debt guaranteed by A. The debt becomes payable. C does not sue B for a year after the debt has become payable. A is not discharged from his suretyship.

(f) **Discharge of surety by creditor's act or omission impairing surety's eventual remedy [Section 139] :** 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 thereby impaired, the surety is discharged.

Example 1 : B contracts to build a ship for C for a given sum, to be paid by instalments as the work reaches certain stages. A becomes surety to C for B's due performance of the contract. C, without the knowledge of A, prepays to B the last two instalments. A is discharged by this prepayment.

Example 2 : A puts M as apprentice to B, and gives a guarantee to B for M's fidelity. B promises on his part that he will, at least once a month, see that M make up the cash. B omits to see this done as promised, and M embezzles. A is not liable to B on his guarantee.

By the invalidation of the contract of guarantee

(a) **Guarantee obtained by misrepresentation invalid [Section 142]:** 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.

(b) Guarantee obtained by concealment invalid [Section 143] : Any guarantee which the creditor has obtained by means of keeping silence as to material circumstances is invalid.

Example 1 : A engages B as a clerk to collect money for him, B fails to account for some of his receipts, and A in consequence calls upon him to furnish security for his duly accounting. C gives his guarantee for B's duly accounting. A does not acquaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid.

Example 2 : A guarantees to C payment for iron to be supplied by him to B for the amount of ₹ 2,00,000 tons. B and C have privately agreed that B should pay five rupees per ton beyond the market price, such excess to be applied in liquidation of an old debt. This agreement is concealed from A. A is not liable as a surety.

(c) Guarantee on contract that creditor shall not act on it until co-surety joins (Section 144): 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 not valid if that other person does not join.

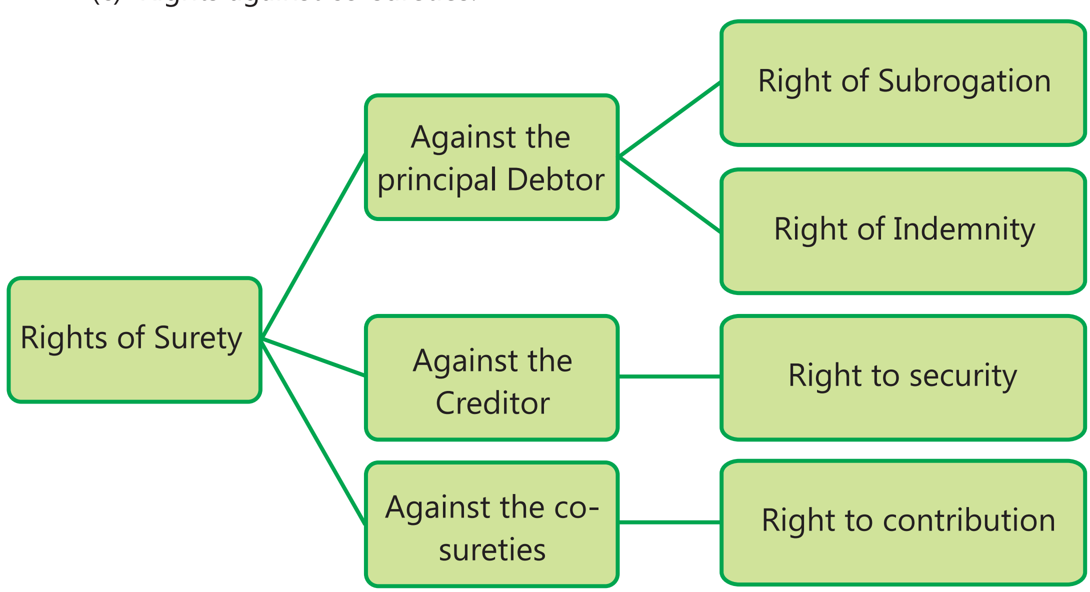
9. RIGHTS OF A SURETY

Rights of a surety may be classified as under :

(a) Rights against the creditor,

(b) Rights against the principal debtor,

(c) Rights against co-sureties.



Right against the principal debtor

(a) **Rights of subrogation [Section 140] :** 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.

This right is known as right of subrogation. It means that on payment of the guaranteed debt, or performance of the guaranteed duty, the surety steps into the shoes of the creditor.

(b) **Implied promise to indemnify surety [Section 145] :** In every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety. 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.

Example 1: B is 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.

Example 2 : 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.

Example 3 : A guarantees to C, to the extent of 2,00,000 rupees, payment for rice to be supplied by C to B. C supplies to B rice to a less amount than 2,00,000 rupees, but obtains from A payment of the sum of 2,00,000 rupees in respect of the rice supplied. A cannot recover from B more than the price of the rice actually supplied.

Right against the Creditor

Surety's right to benefit of creditor's securities [Section 141]: 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.

Example 1 : C advances to B, his tenant, 2,00,000 rupees on the guarantee of A. C has also a further security for the 2,00,000 rupees by a mortgage of B's furniture. C cancels the mortgage. B becomes insolvent, and C sues A on his guarantee. A is discharged from liability to the amount of the value of the furniture.

Example 2 : C, a creditor, whose advance to B is secured by a decree, receives also a guarantee for that advance from A. C afterwards takes B's goods in execution under the decree, and then, without the knowledge of A, withdraws the execution. A is discharged.

Example 3 : A, as surety for B, makes a bond jointly with B to C, to secure a loan from C to B. Afterwards, C obtains from B a further security for the same debt. Subsequently, C gives the up the further security, A is not discharged.

Rights against co-sureties

(a) **Co-sureties liable to contribute equally (Section 146) :** Equality of burden is the basis of Co-suretyship. This is contained in section 146 which states that "when two or more persons are co-sureties for the same debt, or duty, either jointly, or severally and whether under the same or different contracts and whether with or without the knowledge of each other, the co-sureties in the absence of any contract to the contrary, are liable, as between themselves, to pay each an equal share of the whole debt, or of that part of it which remains unpaid by the principal debtor".

Example 1 : A, B and C are sureties to D for the sum of 3,00,000 rupees lent to E. E makes default in payment. A, B and C are liable, as between themselves, to pay 1,00,000 rupees each.

Example 2 : A, B and C are sureties to D for the sum of 1,00,000 rupees lent to E, and there is a contract between A, B and C that A is to be responsible to the extent of one-quarter, B to the extent of one-quarter, and C to the extent of one- half. E makes default in payment. As between the sureties, A is liable to pay 25,000 rupees, B 25,000 rupees, and C 50,000 rupees.

(b) **Liability of co-sureties bound in different sums (Section 147) :** The principal of equal contribution is, however, subject to the maximum limit fixed by a surety to his liability. Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

Example 1 : A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 3,00,000 rupees. A, B and C are each liable to pay 1,00,000 rupees.

Example 2 : A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 4,00,000 rupees; A is liable to pay 1,00,000 rupees, and B and C 1,50,000 rupees each.

Example 3 : A, B and C, as sureties for D, enter into three several bonds, each in a different penalty, namely, A in the penalty of 1,00,000 rupees, B in that of 2,00,000 rupees, C in that of 4,00,000 rupees, conditioned for D's duly accounting to E. D makes default to the extent of 7,00,000 rupees. A, B and C have to pay each the full penalty of his bond.

SUMMARY

- **A contract of indemnity-**A contract where one, party promises to indemnify the other from loss caused to him by the conduct of the promisor or by the conduct of any other person.
- **A contract of guarantee-**A contract to perform the promise or discharge the liability of a third person in case of his default.
- Contract of guarantee must be supported by consideration. The consideration received by the pricipal debtor may be sufficient consideration to the surety for giving guarantee.
- The liability of surety is co-extensive with that of principle debtor. In certain cases surety will be liable though principal debtor is not liable-(i) principal debtor is incompetent to contract. (ii) Principal debtor is adjudged insolvent. (iii) The debts becomes time-barred.
- **Specific/simple guarantee :** Guarantee for single debt/particular transaction.
- **Continuing guarantee :** Guarantee that extends to a series of transactions.

TEST YOUR KNOWLEDGE

Multiple Choice Questions

1. A contract of indemnity is a
   (a) Contingent Contract
   (b) Wagering contract
   (c) Quasi Contract
   (d) Void agreement
2. A contracts to save B against the consequences of any proceedings, which C may take against B in respect of a certain sum of 500 rupees. This is a:
   (a) Contract of guarantee
   (b) Quasi contract
   (c) Contract of indemnity
   (d) Void contract
3. In a Contract of Guarantee there is/are :
   (a) One contract
   (b) Two contracts
   (c) Three contracts
   (d) Four contracts.
4. S and P go into a shop. S says to the shopkeeper, C, "Let P have the goods, and if he does not pay you, I will. "This is a
   (a) Contract of Guarantee
   (b) Contract of Indemnity
   (c) Wagering agreement
   (d) Quasi-contract
5. A guarantee obtained by a creditor by keeping silence as to material circumstances is :
   (a) valid
   (b) voidable
   (c) unenforceable
   (d) invalid

Answer to MCQs

1. (d)	**2.** (b)	**3.** (c)	**4.** (c)	**5.** (b)

Question and Answer

Question 1

M advances to ₹ 5,000 on the guarantee of P. The loan carries interest at ten percent per annum. Subsequently, N becomes financially embarrassed. On N's request, M reduces *the interest to six per cent per annum and does not sue N for one year after the loan becomes due. N becomes insolvent. Can M sue P?*

Answer

M cannot sue P, because a surety is discharged from liability when, without his consent, the creditor makes any change in the terms of his contract with the principal debtor, no matter whether the variation is beneficial to the surety or does not materially affect the position of the surety (Section 133, Indian Contract Act, 1872).

Question 2

What are the rights of the indemnity-holder when sued?

Answer

Rights of Indemnity- holder when sued (Section 125): 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 authorised him to compromise the suit.

It may be understood that the rights contemplated under section 125 are not exhaustive. The indemnity holder/ indemnified has other rights besides those mentioned above. If he has incurred a liability and that liability is absolute, he is entitled to call upon his indemnifier to save him from the liability and to pay it off.

Question 3

Define contract of indemnity and contract of guarantee and state the conditions when guarantee is considered invalid ?

Answer

Section 124 of the Indian Contract Act,1872 says that "A contract by which one party promises to save the other from loss caused to him by the conduct of the promisor himself, or the conduct of any person", is called a "contract of indemnity".

Section 126 of the Indian ContractAct says that "A contract to perform the promise made or discharge liability incurred by a third person in case of his default." is called as "contract of guarantee".

The conditions under which the guarantee is invalid or void are stated in section 142,143 and 144 of the Indian Contract Act are :

(i) Guarantee obtained by means of misrepresentation.

(ii) creditor obtained any guarantee by means of keeping silence as to material circumstances.

(iii) When contract of guarantee is entered into on the condition that the creditor shall not act upon it until another person has joined in it as co-surety and that other party fails to join as such.

Question 4

Mr. X, is employed as a cashier on a monthly salary of ₹ 2,000 by ABC bank for a period of three years. Y gave surety for X's good conduct. After nine months, the financial position of the bank deteriorates. Then X agrees to accept a lower salary of ₹ 1,500/- per month from Bank. Two months later, it was found that X has misappropriated cash since the time of his appointment. What is the liability of Y ?

Answer

If the creditor makes any variance (i.e. change in terms) without the consent of the surety, then surety is discharged as to the transactions subsequent to the change. In the instant case Y is liable as a surety for the loss suffered by the bank due to misappropriation of cash by X during the first nine months but not for misappropriations committed after the reduction in salary. [Section 133, Indian Contract Act, 1872].

Question 5

A contracts with B for a fixed price to construct a house for B within a stipulated time. B would supply the necessary material to be used in the construction. C guarantees A's performance of the contract. B does not supply the material as per the agreement. Is C discharged from his liability.

Answer

According to Section 134 of the Indian Contract Act, 1872, 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 for the creditor, the legal consequence of which is the discharge of the principal debtor. In the given case the B omits to supply the timber. Hence C is discharged from his liability.