

HOLY CROSS HOME SCIENCE COLLEGE THOOTHUKUDI

BUSINESS LAW

UNIT-III :INDEMNITY AND GUARANTEE

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INDEMNITY AND GUARENTEE-

TWO SIDES OF THE SAME COIN

This article aims to understand the technicalities of the terms briefly and analyze the differences and similarities between the two in detail with the aid of appropriate case laws.

Under **section 124** of the Indian contract act 1872, indemnity is a protective compensation package, wherein a person promises to protect from the losses incurred by the promisor or any other individual¹. It is an instance of “original liability” and acts as compensation cover.

There are two categories of individuals involved in a contract of indemnity. It includes an “*indemnifier*” also known as “**indemnitor**”; he is the individual having the liability to compensate. The other category is that of “*indemnified*” or the “**indemnity holder**” or the “**indemnitee**”², he is the person being compensated by the indemnitor. It is an instance of a bilateral agreement to make good of the losses.

Duty to indemnify can arise out of contractual obligations- express or implied statutory obligations or even relations like principal and agent, employer and employee etc³. This has been emphasized in *Kadiresan chettiar V.SpRMRm Ramaswami Chettiar* (1947) AIR 1946 Mad 472. Thus, not always does the duty to indemnify arise out of contracts; it can also be non-contractual as it can be implied which arise out of acts or supposed relationships.

In its 13th report in 1958, The Law Commission of India recommended that indemnity also include instances where losses may or may not happen as result of a person’s conduct⁴. This was to increase the protective cover for compensation and include more chances of indemnifying losses by increasing the scope of the section and making it more pervasive to different situations. However, till date the recommendation stands unincorporated.

¹ POLLOCK & MULLA –“The Indian Contract and Specific Relief Acts”, 14th Edition 2012, editor- Nilima Bhadbhade, volume- ii , 1335-1336.

² Law notes.in- *Contracts of Indemnity*, 18th February 2014, available at http://www.lawnotes.in/Contracts_of_Indemnity.

³ POLLOCK & MULLA, *Supra* note 1, 1340.

⁴ POLLOCK & MULLA, *Supra* note 1, 1336.

Earlier in the English common law the contract of indemnity could not be used till actual loss took place, in other words the indemnifier could not be compelled to compensate till actual loss was suffered by the indemnity holder, however under recent equitable principles any claim to indemnify can be successfully used when the claim is clear and enforceable⁵. This has been emphasized in *Osman Jamal and Sons Ltd. V. Gopal Purshottam* (1928) AIR 1929 Cal 208. Thus as per the new and recent rules any case of probable losses can also invoke indemnity. This was also used in *Gajanan Moreshwar Parelkar V. Moreshwar Madan Mantri* (1942) 44 BOMLR 703.

The Indemnity holder can recover costs when two pre-conditions are fulfilled under **section 125** when he/she is sued⁶-

1. He/she has been authorized by the promisor to “bring or defend” the suit.
2. He/she has not contravened orders and acted in an unreasonable manner.

The extent of liability in indemnity is on a case to case basis. There is no single rule that covers it entirely- it is dependent on agreements between the indemnifier and the indemnified⁷ as seen in *Smith V. South Wales Switchgear Ltd.* (1978) 1 ALL ER 18. Thus courts scrutinize the provisions and accordingly provide compensation packages on a case to case basis.

Under **section 126** of the Indian Contract Act, guarantee is a contract to perform or discharge the duty of any third individual in case of his/her default⁸. It is also an instance of acting as a cover for compensation to protect intended parties from losses.

There are three categories of individuals involved in any instance of guarantee. The person provides the security is the “surety” or “guarantor”, the person whose action or liability is being covered is known as “principal debtor”, the person to whom the principal debtor is originally liable is known as “creditor”⁹. There exists a tripartite agreement between the three to the use of contract of guarantee.

There are different types of guarantees. One of them being “Fidelity Guarantee”¹⁰, the surety in this case assures the creditor the good intention and purpose of the principal debtor and is liable in case of any mal-actions on part of the principal debtor as seen in *Radha Kanta Pal V. United bank of India Ltd* AIR 1955 Cal 217.

⁵ POLLOCK & MULLA, *Supra* note 1, 1343.

⁶ POLLOCK & MULLA, *Supra* note 1, 1350.

⁷ POLLOCK & MULLA, *Supra* note 1, 1345.

⁸ POLLOCK & MULLA, *Supra* note 1, 1352.

⁹ *Id.*, 8.

¹⁰ POLLOCK & MULLA, *Supra* note 1, 1365.

There are instances of bank guarantee as well where the bank undertakes the role of surety to protect the creditor's commercial rights¹¹. The contracts of guarantee as under bank guarantee also include conditional and unconditional guarantees, where in the former surety is liable only when some proof or testimony of the principal debtor's default, whereas in the latter no such proof or testimony is required¹². The duty of the surety to pay is a fixed legal responsibility.

There is also the concept of "Continuing Guarantee" which applies towards more than one single transaction. Though it may be stipulated by putting up any kind of specific limit- time or capital.¹³ As seen in *Bhagvandas Rangildas Vani V. Secy. State for India* AIR 1926 Bom 465 guarantee for payments by installments cannot be construed as an instance of continuing guarantee. It is elucidated in section 129 of the Indian Contract act.

DIFFERENCES BETWEEN INDEMNITY AND GUARANTEE

1. Contracts of Guarantee unlike contracts of indemnity are contracts where three parties are involved¹⁴. In other words while contracts of guarantee involve the surety, principal debtor and creditor, contracts of indemnity involve only the indemnifier and the indemnified. Thus contracts of guarantee involve more parties than contracts to indemnify.

2. In a contract of guarantee there are contracts between the principal debtor and creditor, the creditor and the surety as well as an express or implied contract between the debtor and the surety. In case of a contract of indemnity only the first two contracts are existent with no such corresponding third request¹⁵.

These two differences mentioned have been highlighted in *Ramchandra B Loylka V.Shapurji N.Bhownagree* (1940) BOM 552 by Justice Kania and Beaumont CJ in unanimity. They contended that under **sections 126** and **145** of the Indian contract act, any case of guarantee should have three parties and subsequent contracts between

¹¹ POLLOCK & MULLA, *Supra* note 1, 1366.

¹² *Id.*, note 11.

¹³ POLLOCK & MULLA, *Supra* note 1, 1399-1402.

¹⁴ POLLOCK & MULLA, *Supra* note 1, 1337-1338.

¹⁵ Indiancaselaws.wordpress.com- *Ramchandra B. Loyalka V.Shapurji N. Bhownagree* , 18th February 2014, available at <http://indiancaselaws.wordpress.com/2012/01/22/ramchandra-b-loyalka-v-shapurji-n-bhownagree/>.

them¹⁶. This acts as primary criteria to judge if it is an instance of guarantee or indemnity in case the contract fails to mention so expressly.

3. In case of guarantee two types of liabilities exist- primary and secondary. The primary liability lies with the principal debtor that is he is to be charged first in case of default followed by secondary liability on the surety¹⁷. In case of indemnity there are no such differentiations of liability with parties being treated at par. But in guarantee a creditor can be asked to first enforce his primary right against the principal debtor before reaching out for the surety. Thus enforcement of contract of guarantee is different from enforcing contract of indemnity.

4. In Contracts of Indemnity, indemnifier cannot recover any loss incurred due to the compensation paid as his responsibility to indemnity holder but in case of guarantee the surety has the right to claim compensation from the principal debtor after paying the creditor¹⁸. This rule has been explained in *Radha Kanta Pal V. United bank of India Ltd* AIR 1955 Cal 217. Thus guarantee consists of a duty to payback which is absent in indemnity.

5. Contracts of indemnity are seemingly less complicated than contracts of guarantee as the latter has three parties with three sub-contracts as compared to the former which has two parties with two sub contracts¹⁹.

6. Contracts of indemnity consist of original liability not collateral liability which would make it a contract of guarantee²⁰. This rule has been explained in *Mahabir Prasad V. Siri Narayan* AIR 1918 Pat 345.

7. While contracts of indemnity are formed at the request of indemnifier, guarantee contracts are formed at the instance of the principal debtor²¹. Indemnity is also closely associated with occurrence of actual loss while in contracts of guarantee the legal liability stands confirmed and fixed²².

8. As explained in *Guild and co. V. Conrad* (1894) 2 QB 885, promise to be “independently and primarily” liable is not a guarantee though it may be an instance of

¹⁶ *Id.*, note 15.

¹⁷ lawofbusiness.com- *Indemnity and Guarantee Contract*, 18th February, 2014, available at <http://www.lawsofbusiness.com/2012/03/indemnity-and-guarantee-contract.html>.

¹⁸ *Id.*, note 17.

¹⁹ *Id.*, note 18.

²⁰ POLLOCK & MULLA, *Supra* note 1, 1337-38.

²¹ *Supra* note 17.

²² Indiancaselaws.wordpress.in- *Indemnity and Guarantee*, 18th February, 2014, available at <http://indiancaselaws.wordpress.com/indemnity-and-guarantee/>.

indemnity²³. Guarantee thus is an instance of binding and collateral actions where the responsibility is shared between the principal debtor and the surety.

9. A contract of indemnity does not allow any action any action on the person who has caused loss as indemnity holder is only allowed to sue the promisee²⁴. This scope is wider in the contracts of guarantee. This rule has been explained in *K.V.Periyamianna Marakkayar and Sons V. Banians and Co.* (1929) 49 Mad 156.

SIMILARITIES BETWEEN INDEMNITY AND GUARANTEE

1. Contracts of guarantee and contracts of indemnity perform the similar role of providing security to creditors in case a third party fails to perform his duty in a contract²⁵. Thus they play a very vital role in protecting commercial activities from losses by acting as safeguards in case of anyone's default, which promotes risk taking and entrepreneurship in businesses. They are protective security covers in both the instances wherein parties have certain rights and duties they are supposed to perform in order to reap the benefits of the provisions of the agreement.

2. Neither contract of indemnity nor contract of guarantee is dependent upon the Latin principle of *uberrima fidei*²⁶. The term is used for describing bona fide disclosure of all associated facts and circumstances, primarily in insurance laws. However in the context of indemnity and guarantee it is perfectly fine if parties do or do not reveal all the events as they are not obligated by law to do so. This has been explained in the cases of *British India General Insurance Co. Ltd.*, AIR 1971 Bom 102 (for contracts of indemnity) and *Hukumchand Insurance Co. Ltd. V. Bank of Baroda*, AIR 1977 Kant 204 at 207 (for contracts of guarantee).

CONCLUSION

²³ POLLOCK & MULLA, *Supra* note 1, 1356.

²⁴ POLLOCK & MULLA, *Supra* note 1, 1348.

²⁵ POLLOCK & MULLA, *Supra* note 1, 1355.

²⁶ POLLOCK & MULLA, *Supra* note 1, 1338-1339 and 1359. Also preservearticles.com- *Short essay on the special features of contract of guarantee*, 18th February 2014, available at <http://www.preservearticles.com/2012012621539/short-essay-on-the-special-features-of-a-contract-of-guarantee.html>.

Thus, contracts of indemnity and contracts of guarantee can be termed as an instance of being objects with same purpose but different features. In their technical differences we can observe two separate provisions within the same act. However on closer observation they are meant for the same purpose of ensuring parties are not duped in commercial transactions.

Though the preference of either of the options is very individualistic and depends on the needs and conditions of the parties. Overall these are provisions of law that help business activities take place and bring parties to the same level of bargaining power.

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