

UNIT – III

INDEMNITY AND GUARANTEE

DEFINITION

Section 124 of the Indian Contract Act defines it as “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”. The person who promises is called the Indemnifier and the person to whom the promise is made is called the Indemnified or Indemnity Holder.

Illustration: A promises not to construct buildings on a particular site so as to prevent light and air to B’s house and in case of breach of such promise, to indemnify for the consequent loss.

This is a contract of indemnity. A contract of insurance is also a contract of indemnity.

RIGHTS OF AN INDEMNITY HOLDER

He is entitled to recover—

- All damages
- All costs which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnity applies, and
- All sums which he may have paid under the terms of any compromise of any such suit provided, such compromise was not contrary to the orders of the promisor and was prudent or the promisor authorizes him to compromise the suit.

CONTRACT OF GUARANTEE

Section 126 of Indian Contract Act defines it as “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”.

Illustration: A purchases goods from B on credit. C agrees to stand as a surety which means that if A does not pay the price of the goods, he will pay. Here, A is the principal debator, B is the creditor and C is the surety or guarantee.

Distinction between Contract of Indemnity and Contract of Guarantee

	Contract of Indemnity	Contract of Guarantee
1	There are two parties, namely Indemnifier and the Indemnified.	There are three parties, viz the principal debtor, the creditor and the surety
2	The liability of the Indemnifier is primary	The liability of the surety is subsidiary

3	The liability of the Indemnifier is contingent	The liability of the surety is subsisting
4	The Indemnifier cannot sue the third party in his name even after making good the loss unless there is an assignment in his favour from the indemnified.	The surety can sue the principal debtor in his own name after paying the creditor

RIGHTS OF SURETY

Rights against the Principal Debtor

- 1) After discharging the liability of the principal debtor, the surety is entitled to all those rights which the creditor himself exercises against the principal debtor. This right of the surety is called “subrogation”.

Illustration: The right of the creditor to receive dividends from the official assignee when the principal debtor becomes bankrupt, can be exercised by the surety.

- 2) The surety can proceed against all those securities of the principal debtor, which the creditor himself can proceed against.
- 3) The surety is entitled to be indemnified for all payments rightfully made by him.

Illustration: 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.

Rights against the Creditor

- 1) The surety may require the creditor to sue the debtor. But he cannot compel the creditor to do so.
- 2) In the case of fidelity contracts, he can insist upon the creditor to dispense with the services of the principal debtor when his dishonesty is established.
- 3) He can claim set off or counter-claim which the principal debtor could have obtained against the creditor.
- 4) On payment of the guaranteed debt, he can require the creditor to assign to him all the securities held by the creditor in respect of the debt. If the creditor loses or parts with such securities without the consent of the surety, the surety is discharged to the extent of the value of the security.

Illustration: C advances to B, his tenant, Rs. 2000 on the guarantee of A. C has also a further security for the sum of Rs. 2000 by 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.

Rights against the Co-Sureties

- 1) All the sureties shall bear equally, the loss caused by the insolvency of the principal debtor. If one of them bears the entire loss in the first instance he can claim contribution from other co-sureties.
- 2) Where the co-sureties agreed to become liable in different sums, they should contribute, according to English Law, proportionately.

Illustration: A, B and C have agreed to become liable for Rs. 10,000, 20,000 and 40,000 respectively, as sureties for D's liability. D's indebtedness was Rs. 30,000. A, B and C would contribute in the ratio of 1 : 2 : 4. But according to Indian Law they shall bear such loss equally but not exceeding the sums which they have agreed to pay. So, A, B and C will have to pay Rs. 10,000 each.

SURETY DISCHARGED FROM LIABILITY

1. The surety is discharged from liability if the contract of guarantee becomes void or voidable, on the ground of misrepresentation by the creditor with regard to a material circumstance, or on the ground that the guarantee was given on condition that another person will join as a co-surety and that such other person has not joined as such.

Illustration: A engages B as 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 accounting. C gives his guarantee for B's accounting. A does not acquaint C with B's previous conduct. B afterwards makes default. The guarantee is invalid.

2. The surety is discharged by revocation as to future transaction in case of continuing guarantee.
3. The surety is discharged
 - a. ***By variance of contract:*** Any variance in the terms of the contract between the principal debtor and the creditor without the surety's consent discharges the surety.

Illustration: C, contracts to lend B Rs. 5000 on the 1st of March. A guarantees repayment. C pays Rs. 5000 to B on the 1st of 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 of March.

- b. ***By release or discharge of principal debtor:*** The surety is discharged by any contract between the principal debtor and the creditor by which the principal

debtor is discharged or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor.

Illustration: 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 surety ship.

- c. **By composition with debtor:** The surety is discharged when the principal debtor and creditor enter into a contract by which the creditor (1) composition with or (2) promises to give time or (3) promises not to sue the principal debtor.
- d. **By act or omission impairing surety's remedy:** The surety is discharged if the creditor does any act inconsistent with the rights of the surety or omits to do any act which his duty to surety requires him to do.

Illustration: A puts M as apprentice to B, and gives a guarantee in B for M's fidelity. B promises on his part that he will, at least once a month, see 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.

- e. **Loss of security:** the surety is discharged if the creditor loses or parts with the securities belonging to the principal debtor, without the consent of the surety.

The surety is not discharged in the following cases:

- 1. A surety is not discharged when a contract to give time to the principal debtor is made by the creditor with a third person and not with the principal debtor.

Illustration: 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.

- 2. Mere forbearance on the part of the creditor to sue the principal debtor does not discharge the surety.

Illustration: B owes 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 liability.

- 3. Release of one co-surety does not discharge the other.

CONTRACTS OF BAILMENTS

Section 148 of the Indian Contract Act defines that "a bailment is the delivery of goods by one person to another for some purpose, upon a contract that they shall when the purpose is accomplished, be returned or otherwise disposed of according to the directions of the person delivering them." The person delivering the goods is called the "bailor". The person to whom they are delivered is called the "bailee".

Essentials of Bailments

- 1. There must be delivery of goods: Such delivery may be actual or constructive.
- 2. The delivery must be made for some specific purpose.

3. The delivery must be made on condition that the goods shall be returned in specific when the purpose is over, or disposed of according to the direction of the bailor.
4. Only possession but not the ownership of the goods is transferred.

Examples: Delivery of a radio for repair.

DUTIES OF A BAILEE

1. To take reasonable care of the goods bailed to him

Section 151 lays down that in all cases of bailment the bailee should take that much of care which an ordinary prudent man would take of his own goods under similar circumstances. Section 152 lays down that the bailee is not responsible, in the absence of any special contract, for the loss, destruction or deterioration of the thing bailed, if he has taken the amount of care described above.

Illustration: A gives to B, to be made into an ornament. B keeps them in a safe where he usually keeps his own valuables. B is not liable if the goods are lost by him.

2. Not to make unauthorized use of goods bailed

The bailee should not make use of goods for purposes inconsistent with the terms of the contract. If he does so, the bailor is entitled to terminate the contract and claim damages, if any.

Illustration: A lends a horse to B for his own riding only. B allows C, to ride the horse. C rides carefully but the horse accidentally falls and is injured. B is liable to compensate A for the injury caused to the horse.

3. Not to mix the goods of the bailor with his own goods

- a) If a bailee mixes the goods of the bailor with his own goods with the consent of the bailor, both the bailor and the bailee shall have proportionate interest in the mixture.
- b) If the goods mixed by the bailee without the consent of the bailor and the goods are separable, the bailee is bound to bear the expenses of separation and pay damages if any.
- c) If the goods are mixed by the bailee without the consent of the bailor and the goods are inseparable, the bailee should compensate the bailor for the loss of goods.

Illustration: A bails a barrel of Cape flour worth Rs. 45 to B. B without A's consent, mixes the flour with country flour of his own, worth only Rs. 25 a barrel. B must compensate A for the loss of his flour.

4. Not to set up adverse title

The bailee should not deny the bailor's title. He should not set up his own title or that of a third party.

5. To return the goods bailed

The bailee should return goods bailed, to the bailor when the fixed period is over or when the purpose is accomplished. The bailee should also deliver any increase or profit which may have accrued from the goods bailed.

Illustration: A leaves a cow in the custody of B to be taken care of. The cow has a calf. B is bound to deliver the calf as well as the cow to A.

DUTIES OF A BAILOR

1. To disclose the faults in the goods bailed

The bailor should disclose to the bailee, faults in the goods bailed, of which he is aware. If he does not disclose, he will be liable for the loss resulting therefrom.

Illustration: A lends a horse which he knows to be vicious to B. He does not disclose this fact. The horse runs away. B is thrown down and injured. A is responsible to B for damages sustained.

2. To bear extra-ordinary expenses

While the ordinary expenses are payable by the bailee, extra-ordinary expenses shall be borne by the bailor.

Illustration: Where a horse is lent for a journey, the bailee shall bear the expenses of feeding the horse. But in case of the horse becoming sick, the bailor shall have to bear the necessary expenses for its recovery.

3. Responsibility for want of title

The bailor is responsible to the bailee for any loss sustained by the latter by the reason, that the bailor was not entitled to make the bailment or to receive back the goods or to give directions respecting them.

RIGHTS OF BAILOR

1. He is entitled to the increase or profit from goods bailed
2. In the case of gratuitous loan, the lender may require the goods to be returned, even though he lent it for a fixed period for specific purpose. But if such a request causes loss to the bailee exceeding the benefit he derives, the bailor should indemnify the borrower.
3. The bailor is entitled to terminate the contract when the bailee does any act inconsistent with the terms of bailment.

Illustration: A gives a horse to B for hire for his own riding. B drives the horse in his carriage. The bailment can be terminated at the option of A.

LIEN

Lien is a right of a person, who has possession of goods of another, to return such possession until a debt due to him has been discharged. This right is called a “Possessory lien”.

Lien is of two kinds: 1. Particular lien, and 2. General lien

1. A Particular Lien is one which is available only against that property in respect of which the skill and labour are exercised or any expenses are incurred.

Illustration: A delivers a watch for repairs to B, a repairer. B has a right to retain the watch till he is paid for the services rendered.

The bailees, repairers and unpaid vendors of goods are entitled to particular lien.

2. A General Lien is the right to retain the property of another for a general balance of accounts. Bankers, can exercise this right for any debt due to them.

The duties and rights of A finder of lost goods

A person who finds an article need not take charge of it. But if he takes them into his possession, he becomes a bailee.

Duties and Rights

1. He must take as much care of the goods as an ordinary prudent man would, under similar circumstances, take of his own goods.
2. He cannot sue for remuneration for trouble and expense incurred by him to preserve the goods or to find out the owner of the goods.
3. He may exercise particular lien against the goods for such remuneration.
4. If a reward has been offered for the return of the goods, he can sue for such reward.
5. If the goods are the subject of the sale and if the owner is not found or when found refuses to pay the lawful charges, the finder may sell the goods.
 - a. When the goods are about to perish or
 - b. When they lose the greater part of their value or
 - c. When lawful charges amount to two-thirds of their value

PLEDGE

A pledge is a “bailment of goods as security for payment of a debt or performance of a promise”. The bailor is called the “pawnor” and the bailee is called the “pawnee”. In the case of pawn, there is no transfer of property in goods. Only possession of the goods is transferred. Hence, it is different from mortgage. Pawn is also different from lien, as in the case of lien, there is not power to sell the article while a pawnee can sell, subject to some conditions.

Rights of Pawnor

Even after the expiry of a stipulated period, he may redeem the goods pledged at any subsequent time *before the actual sale of the goods pledged*. But he must pay expenses which may have arisen from his default.

Rights of Pawnee

1. He can retain the goods pledged until he recovers the debt, interest and other expenses incidental to possession or preservation of the goods.
2. He cannot retain the goods for debts other than those for which pawn is made.
3. He is entitled to receive extra-ordinary expenses incurred for the preservation of goods.
4. If the pawnor makes a default, the pawnee may
 - a. Bring a suit upon the debt or promise and
 - b. Retain the goods pledged or
 - c. Sell the goods by giving a reasonable notice of sale to the pawnor.

If the proceeds of such are less than the amount due in respect of the debt or promise, the pawnor is still liable to pay the balance. If the proceeds of the sale are greater than the amount so due, the pawnee shall pay over the balance to the pawnor.

PLEDGE BY NON-OWNERS

Generally it is only the owner of goods who has the power and authority to pledge the goods, but in some cases even the non-owners can pledge the goods. The cases where the non-owners can pledge the goods are the following:

1 Mercantile Agents: In this case the agent has a right to pledge the goods in the ordinary course of business with the consent of the owner.

2 Pledge by seller or buyer in possession after sale: There are two situations in this. In the first situation the seller is left with possession of goods after sale has been made. In the second situation the buyer obtains possession of goods with the consent of the seller before the sale has been made. According to section 30 of the Sale of Goods Act 1930, in both the situations the respective possessors of goods have the right to pledge the goods provided the Pawnee or the Pledgee acts in good faith and has no notice of the previous sale of goods to the buyer or of the lien of the seller over the goods.

3 Pledge where Pawnor has limited interest: According to section 179 of the Indian Contract Act, “where a person pledges goods in which he / she has limited interest, the pledge is valid to the extent of that interest. A person having a lien over the goods or a finder of goods may pledge them to the extent of his /her interest”.

4 Pledge by co-owner in possession: Where the goods belong to more than one owner, one of the several co-owners of goods who is in possession of the goods with the consent of the other owners has a right to create a valid pledge of the goods.

5 Pledge by person in possession under voidable contract: According to section 178-A, “if a person obtains possession of goods under a voidable contract, the pledge created by him / her is valid provided:

- (1) The contract has not been rescinded before the contract of pledge

(2) The Pawnee acts in good faith and has no knowledge about the defective title of the Pawnor”.