UNIT – I

Contract of Indemnity & Contract of Guarantee

Sections 124–147 • Rights of Indemnity Holder • Surety's Liability • Discharge of Surety

OVERVIEW

Unit Structure

01

Contract of Indemnity

S. 124–125 – Definition, nature, rights of indemnity-holder

02

Contract of Guarantee

S. 126–147 – Definition, essentials, distinction from indemnity

03

Surety's Liability & Rights

Extent of liability, rights against principal debtor & creditor

04

Discharge of Surety

Modes of discharge – S. 130–141

Contract of Indemnity – Definition

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”.

Example: A contracts to indemnify B against the consequences of any proceedings which C may take against B in respect of a certain sum of ₹200. This is a contract of indemnity.

Key features:
• Promise to save from loss
• Loss may be caused by the promisor or by a third person
• The loss must be caused by human conduct (not by accident or natural causes under the Act, though English law is wider)
• It is a contingent contract

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.

Contract of Guarantee – Definition

Section 126: 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.

Essentials:
- Concurrence of three parties (creditor, principal debtor, surety)
- Distinct promise by the surety to pay on default
- The principal debtor’s liability may be existing or future
- Consideration (may move from the creditor to the principal debtor)

DISTINCTION

Indemnity vs Guarantee – Key Differences

Point	Indemnity	Guarantee
Parties	Two parties	Three parties
Liability	Primary	Secondary (on default)
Object	Save from loss	Security for debt/duty
Number of contracts	One	Three (principal + two collateral)
Sections	Ss. 124–125	Ss. 126–147

Extent 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.

Meaning:
- Surety is liable for the whole of the amount that the principal debtor owes (including interest and costs if so provided)
- The creditor can proceed against the surety without first exhausting remedies against the principal debtor
- The surety's liability is secondary in the sense that it arises on default, but once default occurs it is co-extensive

Illustration: 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.

Continuing Guarantee & Its Revocation

Section 129: A guarantee which extends to a series of transactions is called a “continuing guarantee”.

Section 130: A continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor.

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.

A continuing guarantee remains in force until it is revoked or the series of transactions ends. Revocation does not affect liability already incurred.

Discharge of Surety – Key Modes

S. 133 – Variance

Any variance made without the surety's consent in the terms of the contract between principal debtor and creditor discharges the surety as to transactions subsequent to the variance.

S. 134 – Release / 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 which has the legal consequence of discharging the principal debtor.

S. 135 – Composition / Promise to give time

A contract between creditor and principal debtor by which the creditor makes a composition, or promises to give time, or not to sue, discharges the surety unless the surety assents.

S. 139 – Creditor's Act / Omission

If the creditor does any act 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 is thereby impaired, the surety is discharged.

Rights of Surety

Section 140 – Rights 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.

Section 141 – 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.

Other rights: Right of subrogation, right to indemnity from the principal debtor (S. 145), right to contribution from co-sureties (S. 146–147).

Co-sureties – Contribution

Section 146: Where 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.

Section 147: Co-sureties who are bound in different sums are liable to pay equally as far as the limits of their respective obligations permit.

The right of contribution arises only after the surety has paid more than his share.

Landmark Judgments

Gajanan Moreshwar v. Moreshwar Madan (1942)

On the rights of the indemnity-holder and the commencement of the indemnifier's liability.

Bank of Bihar v. Damodar Prasad (1969)

Supreme Court – liability of surety is co-extensive; creditor need not exhaust remedies against principal debtor first.

State of M.P. v. Kaluram (1967)

On the surety's right to the benefit of securities and the effect of the creditor parting with security.

Amrit Lal Goverdhan Lalan v. State Bank of Travancore (1968)

Variance in the terms of the contract without surety's consent discharges the surety.

Further Important Decisions

Punjab National Bank v. Surendra Prasad Sinha (1992)

On the nature of continuing guarantee and the rights of the bank as creditor.

Maharashtra SEB v. Official Liquidator (1982)

Surety's liability remains even when the principal debtor is in liquidation.

Polak v. Everett

Classic English authority on the effect of variance in the contract.

M.S. Anirudhan v. Thomco's Bank (1963)

On the construction of guarantee documents and the extent of surety's liability.

SUMMARY

Key Takeaways – Unit I

- Indemnity (S. 124) is a promise to save from loss caused by the promisor or a third person.
- Guarantee (S. 126) involves three parties; surety's liability is secondary but co-extensive (S. 128).
- Continuing guarantee can be revoked as to future transactions by notice or by death of surety.
- Any material variance without surety's consent discharges the surety (S. 133).
- Surety has rights of subrogation, indemnity and contribution, and is entitled to the benefit of securities.
- Creditor's act or omission impairing the surety's eventual remedy discharges the surety (S. 139).

Quick Reference – Important Sections

Definition of Indemnity	S. 124
Rights of Indemnity-holder	S. 125
Definition of Guarantee	S. 126
Surety's Liability co-extensive	S. 128
Continuing Guarantee	S. 129
Revocation of Continuing Guarantee	Ss. 130–131
Discharge by Variance	S. 133
Rights of Surety on Payment	S. 140
Benefit of Securities	S. 141
Contribution between Co-sureties	Ss. 146–147

Practical Importance

- Bank guarantees and performance guarantees are everyday applications of the law of guarantee.
- Indemnity clauses are standard in commercial contracts, insurance and construction agreements.
- Courts strictly construe any variation that may discharge the surety – banks and creditors must obtain the surety's consent for any material change.
- The right of the surety to securities is frequently litigated when the creditor releases collateral without consent.
- Understanding the distinction between indemnity and guarantee is essential for drafting and for determining the nature of liability.

FLOW

Scheme of Sections 124–147

1	2	3	4	5	6
Indemnity	**Guarantee Defined**	**Liability of Surety**	**Continuing Guarantee**	**Discharge of Surety**	**Rights of Surety**
Ss. 124–125	S. 126	S. 128	Ss. 129–131	Ss. 133–139	Ss. 140–147

COMPARATIVE

Primary vs Secondary Liability

In a contract of indemnity the indemnifier's liability is primary – he is bound to make good the loss as soon as it occurs.

In a contract of guarantee the surety's liability is secondary – it arises only when the principal debtor defaults. Once default occurs, however, the liability becomes co-extensive and the creditor may proceed directly against the surety.

This distinction is fundamental for determining when the cause of action arises and against whom the suit may be filed.

High-Value Exam Points

- Write the exact definition from S. 124 and S. 126.
- Always mention that surety's liability is co-extensive (S. 128) and that the creditor need not proceed against the principal debtor first (Bank of Bihar v. Damodar Prasad).
- List the modes of discharge of surety with section numbers.
- Explain the right to securities (S. 141) with the consequence of the creditor parting with security.
- Distinguish indemnity and guarantee in a tabular form.
- Mention continuing guarantee and its revocation (Ss. 129–131).

End of Unit – I

Contract of Indemnity & Contract of Guarantee
Sections 124–147 of the Indian Contract Act, 1872

Proceed to Unit-II: Bailment, Finder of Goods & Pledge