VOLUME 1 | ISSUE 4

INTERNATIONAL JOURNAL OF ADVANCED LEGAL RESEARCH

CRITICAL ANALYSIS: INDEMNITY CONTRACTS AND GUARANTEE CONTRACTS

- Purushraj Patnaik[1]

ABSTRACT

Contract compensation and warranty contracts are a kind of contingent contract governed by contract law. Simply put, indemnification refers to monetary recompense as a form of protection against financial loss. Indemnity occurs when one party promises to compensate the other for a loss sustained by the other party as a result of the promisor's or any other party's conduct. The guarantee, on the other hand, happens when a person promises to the other party that if he or she fails to keep the promise or fulfil the third party's obligation, he or she will complete the promise or fulfil the third party's responsibility.

INTRODUCTION

The majority of people choose an indemnity or guarantee contract to safeguard their interests when going into a deal. These two appear to be identical at first glance, however there are minor differences between them. The goal of this research is to provide us an overview of how indemnification and guarantee contracts are similar and different.

INDEMNITY CONTRACTS: MEANING AND ESSENTIALS

Indemnity Contracts[2] are defined under section 124 of the Indian Contract Act of 1872 as a contract in which one party undertakes to protect the other from damages arising from the conduct of the promisor, or from the actions of another person.

For example, X may agree that if Y is not able to pay its monthly rental costs on Z (a PG), X is, on behalf of Y, obliged to return the losses that Z has earned in connection with Y's activities.[3]

The definition of an indemnification contract includes both stated and implied commitments.

If a party is interested in paying money, which another person has to pay by law and so pays himself, he shall be compensated under Section 69.[4]

---

[1] Student at Kalinga Institute of Industrial Technology, Bhubaneswar, Odisha

[2] Section 124, Indian Contract Act, 1872.

[3] Contract of Indemnity, accessible at: http://www.lawnotes.in/Contracts_of_Indemnity#ixzz2sqefMeVf, last accessed on June 22, 2021.

[4] Section 69, Indian Contract Act, 1872.

A party shall have the right to demand compensation from the principal defaulter for whatever money he has legally contributed to the Sec.145 guarantee.[5]

The principle is responsible for compensating the agent for any payments he pays under section 222 in the legal exercise of his power.[6]

The essential features of an indemnity contract are-

• It is unconditional intention to compensate for particular loss or harm, which is aimed to ensure that an aggrieved party has a precise remedy for bugs or defects in products or services provided for under the Contract. It is a promise to compensate or safeguard against harm, loss or harm. It is not an additional, but a distinct contract.

• It is a system for assigning duties depending on risks.

• The provision for compensation must be uncomplicated, to the extent and should determine the circumstances in which compensation is given whenever possible. It shall be considered in the light of any exclusion of the liability provisions included in the Agreement, and the damages to be paid if the clause is utilized favorably should be specified.

The Indian Contract Act of 1872 has excluded indemnifier rights. In the case of ***Jaswant Singh v. State***[7], The entitlement of the indemnifier was judged to be comparable to that of the security pursuant to Section 141 where the indemnifier is entitled to the benefit of all the creditor's securities in relation to the primary debtor, whether the principal debtor is worried about them or not. When a person agrees to reimbursement, he is branded as having succeeded in all of the ways and means by which the person initially rewarded may have been able to protect himself against loss or damages or be prepared to repay him for his loss or loss.

When the compensator pays for the losses or damages, he immediately steps into the shoes of the compensated person providing him all of the rights to defend himself against losses or injury from the original indemnifier.

Indemnity is a legal release from the consequences or responsibilities of a certain course of conduct. Simply defined, an indemnity contract requires one party to reimburse the other, if a third party incurred specific expenses mentioned in the compensation agreement. For example, vehicle rental companies require that the renter of the car be liable for any damage or loss done to the car by the person himself or herself in a careless or negligent manner and that he or she must pay the company for his or her car rental.

[5] Section 145, Indian Contract Act, 1872.
[6] Section 222, Indian Contract Act, 1872.
[7] Jaswant Singh v. Section of State, 14 BOM 299.

In the IT business, indemnification contracts have become more common in recent years. There are various circumstances or situations in which the continuance of an indemnity makes a significant difference for some people, while it makes little or no difference for others. In the law of contract, a novel notion known as "Indemnity Lottery" asserts that results in civil indemnity claims can never be foreseen.

Liability concerns can never be solved with a simple indemnification clause. Those who try to escape culpability or seek liability relief for their conduct will find the law unfavourable to them. The fundamental reason is that a negligent person should not be permitted to transfer all claims and damages against him fully to a non-negligent party. For example, if you are searching for a distinctive manner to speak, try A ticket to an entertainment park says that a person entering the Park is not liable for any damage caused by driving problems or other events. However, because it is not founded on a contract, such a defence seldom succeeds in court.

CONTRACT OF GUARANTEE: MEANING AND ESSENTIALS

A contract of guarantee[8] is defined under Section 126 of the Indian Contract Act as a contract to fulfil a promise or alleviate the defaulting party's obligation if he fails to fulfil his commitment. The essentials[9] of a guarantee contract can be summarized as:

- **It has to be done with the consent of all three parties.**

The primary debtor, the creditor, and the surety, all three parties to the transaction, must agree to create such a contract with each other's consent. It's worth noting that the surety only agrees to be responsible for the primary debtor's debt if the principal debtor specifically requests it. As a result, the primary debtor must communicate with the surety, either explicitly or implicitly. The communication of the guarantee with the creditor to enter into a guarantee contract without the main debtor's knowledge does not lay down a guarantee contract.

For example, Sam gives Akash a loan. The creditor is Sam, and the primary debtor is Akash. Without informing Akash, Sam contacts Raghav to act as the surety. Raghav concurs. This is incorrect.

- **Consideration**

Anything made or any promise made for the benefit of the principal debtor is enough for the

[8] Section 126, Indian Contract Act, 1872.

[9] Contract of Guarantee, accessible at: http://www.lawnotes.in/Contract_of_Guarantee#ixzz2uGPMTPeF, last accessed on June 22, 2021.

guarantee,[10] according to section 127 of the act. The consideration must be a new consideration from the creditor, not one from the past. It is not required for the guarantor to receive any payment, and sometimes simply the creditor's tolerance in the event of default is sufficient consideration.

The State Bank of India threatened legal action against the debtor-defendant in State Bank of India v. Premco Saw Mill[11], but her spouse consented to become a guarantee and agreed to pay the responsibility and also wrote a promissory bill for the State Bank and refused to do so. The decision was made to make good recompense for the assurance for the tolerance and acceptance of the bank.

- **Liability**

Under a guarantee agreement, the duty of a collateral is secondary. This shows that the principal debtor has a substantial obligation to meet the terms of the contract as the primary contract was between the creditor and the principal debtor. The security is exclusively liable for reimbursement when the principal debtor fails.

- Pre-supposes the existence of a debt

The primary object of the guarantee contract is to ensure that the principal obligation of the debtor is paid. If there is no such debt, there is nothing left to safeguard. Therefore, the security has no duty in cases when the debt is time-barred or illegitimate. In the Scottish case of Swan v. Bank of Scotland[12], the House of Lords decided that there can be no legal guarantee if there is no primary obligation.

- Essentials of a valid contract to be satisfied

Since a warranty contract is a kind of contract, all legal contract requirements apply to warranty contracts as well. Consequently, all the essential aspects of a contract in force must be fulfilled, including free consent, a genuine offer for consideration and acceptance, and the willingness to establish a legal relationship.

- No concealment of facts or misrepresentation

The creditor must notify the guarantee of any information that may affect the liability of the guarantee. The promise that this information is disguised is null and void. Consequently, if the creditor receives the guarantee by disclosing the necessary information, the guarantee is worthless. The assurance should not be gained by deceiving with the facts. Although Uberrima fides does not have a guarantee contract, or absolute good faith, the principal debtor or the

[10] Section 127, Indian Contract Act, 1872.
[11] State Bank of India v. Premco Saw Mill, (1983) 2 GLR 1322.
[12] Swan v. Bank of Scotland, (1836) 10 Bligh NS 627.

creditor does not need the disclosure of all relevant facts to the security before the conclusion of a contract. However, information that may likely affect the scope of the obligation of the guarantee must be disclosed correctly.

The rights of a surety are illustrated below:

i. As against the creditor-

Sec. 133[13] – The creditor may not change the conditions of the creditor-principal debtor arrangement without the consent of the surety. Any such change releases the guarantee on transactions resulting from the difference. However, if the modification is made for the surety's benefit, does not favour him, or is of an insignificant nature, it may not result in the surety's release.

Sec. 134[14] - The creditor should not release the primary debtor from the agreement's obligations. The release of the primary debtor has the effect of also releasing the surety. Any enactment or exclusion from the creditor that has the legal effect of releasing the primary debtor brings the surety's responsibility to an end.

Sec. 135[15] -The surety is released unless he consents to an arrangement between the Creditor and the Principal Debtor for deepening the latter's obligation or giving a guarantee to him of increased time for performing the commitments or swears up and down not to beyond any question.

Section 139[16] - the surety is freed if the creditor limits the surety's ability to sue the primary debtor.

ii. As against the principal debtor-

Subrogation - The surety has a right of subrogation if the obligation is paid in full.

Sec. 140[17] - The surety cannot claim subrogation to the creditor's securities if he has committed to function as a security for a portion of the contract and the creditor has obtained security for the whole amount.

---

[13] Section 133, Indian Contract Act, 1872.
[14] Section 134, Indian Contract Act, 1872.
[15] Section 135, Indian Contract Act, 1872.
[16] Section 139, Indian Contract Act, 1872.
[17] Section 140, Indian Contract Act, 1872.

CRITICAL ANALYSIS BETWEEN THE CONTRACTS

Both indemnity and guarantee are forms of compensation that are based on comparable concepts such as good faith, unfair enrichment, and so on.[18] Despite the fact that they are based on the same set of principles, the concepts of indemnity and guarantee differ on a number of problems and technicalities. The researcher will attempt to vividly describe the ideas of guarantee and indemnity, as well as the contrasts and similarities between these two notions, in this article. There are a lot of similarities between guarantees and indemnities. Similarly, there are a lot of similarities in terms of responsibilities and rights.

Contracts of indemnification and contracts of guarantee have several key characteristics.[19] One side agrees to pay in the interest of the other in every contract. In addition, each of these types of contracts is used to protect people and organisations from catastrophes. Another similarity worth highlighting is that they cannot be utilised to benefit themselves unfairly. In a comparison of ***Punjab National Bank Ltd. v. Bikram Cotton Mills and Anr***[20] and ***GajanMoreshwar v. MoreshwarMadan***[21], it can be seen that both guarantee and compensation are used for reimbursement for the creditor and compensation holder, and the main debtor and security for the Punjab National Bank case and the indemnifier agreed to pay to repay the debt. Longman's dictionary of current English[22] defines indemnification as "insurance against loss, particularly in the form of a promise to pay, or recompense for loss of money, commodities, or other property." An indemnification agreement is a legal contract between two parties in which one undertakes to reimburse/compensate the other for injury if specific requirements and conditions are met, unless alternative circumstances are stated. A contract of indemnity is defined as “a contract by which one party promises to safeguard the other from damage caused to him by the promisor's behaviour, or by the action of any other person” under the Indian Contract Act of 1872. For example, A may agree to hold B harmless from the repercussions of any legal action brought by X against B in relation to any consideration, such as an amount of Rs 500 or any other commodity, etc. This is an indemnification contract because one party (A) pledges to protect the other party (B) from any damage caused by the actions of another person (C).[23]

---

[18]SagnikSaha, *Indemnity and guarantee*, accessible at: https://www.lawctopus.com/academike/indemnity-and-guarantee/, last accessed on June 22, 2021.

[19]DeekshaTiwari, *Contract of Indemnity and Guarantee*, accessible at: http://www.legalserviceindia.com/legal/article-4039-contract-of-indemnity-and-guarantee.html, last accessed on June 22, 2021.

[20] Punjab National Bank Ltd. v. Bikram Cotton Mills and Anr, 1970 AIR 1973.

[21]GajanMoreshwar v. MoreshwarMadan, (1942) 44 BOMLR 703.

[22]Longman’s Dictionary Of Contemporary English (Edition 2019).

[23]Dr. R.K. Bangia, *Contract-II*, 7-9 (6th Edition, 2015), Allahabad Law Agency, Haryana.

There are two parties to a compensation contract: the compensator and the compensated. The pledgee who pledges the other party to pay for the damage sustained is known as the compensator. The person is indemnified for damages sustained as a result of the activities of the promisor/or indemnifier by any other person. The person compensated is also known as the compensation holder.

The rights of the compensation holder if he or she is prosecuted are laid out in section 125. Under this Article, the compensation holder is entitled to recover from the Promoter all damages he may have been forced to pay in any suit in connection with the contract, all costs incurred in the institution and defence of the suit, and all amounts payable in accordance with the terms and conditions of any compromis. It was nonetheless emphasised that the compromise must not contravene the directions of the compensator.

The principal debtor, the creditor and the guarantee agree to the guarantee agreement. The guarantee contract is defined in accordance with Section 126 of the 1872 Indian Contract Act. Under Section 126, a "guaranty contract" is a contract where a third party exercises his promise or fulfils his or her duty if he or she fails. The person providing the guarantee is known as the "securety," the default person is the "principal debtor," and the person to whom the guarantee is provided is known as the "creditor" pursuant to Article 126. The last line of section 126, "A guarantee may be oral or written," implies that no evidence is required to establish that it exists and an implicit assurance is sufficient. A guarantee, however, must be written and signed in English law by the party to whom the guarantee is charged in order to be legitimate.

To create a legal guarantee contract, much consideration is required. A contract of guarantee loses its validity and becomes void if there is no compensation. In the event of a guarantee, there is no necessity for direct consideration between the creditor and the guarantee. Even if the creditor has done anything to aid the principal debtor, this is sufficient consideration. — "Anything made or any promise made for the benefit of the primary debtor can be considered sufficiently as to the guarantee," which implies that the benefit of the major debtor is adequately considered.

A further important component of a valid guarantee contract is the voluntary assent of the collateral. As indicated in sections 142 and 143, the promise obtained by disappointment and disguise is invalid. Silence on key facts/circumstances that might influence and affect the consent of the guarantee would also render the guarantee agreement unlawful. For example, if a collateral is forced, despite the fact that the employee is indebted to a higher extent than the guarantor, to guarantee the behaviour and future obligations of the employee, the collateral is unacceptable and the guarantee contract is worthless.

The Supreme Court held in State Bank of India v. MulaSahakariSakharKarkhana[24] that whether a contract is a guarantee or an indemnity contract is an issue of construction in each case.

The primary distinction between an indemnification and a guarantee contract is the number of parties involved. In the event of an indemnity contract, two parties are involved: the indemnifier and the indemnified. A contract of guarantee has three parties: the creditor, the primary debtor, and the surety.

Second, the purpose of an indemnity contract is to compensate a loss and to shield the promisee against a potential loss. A contract of guarantee, on the other hand, has as its primary goal the protection of the creditor in the event of a default by the principal debtor.[25]

Third, the indemnifier's responsibility in the case of an indemnity contract is primary in nature and is reliant on the occurrence of an event or a condition. A surety's liability is secondary in nature under a guarantee contract, and it arises only when the primary debtor fails.

Fourth, the indemnifier's rights are comparably restricted in the case of an indemnity contract, and the indemnifier can only sue the third party if there is an assignment in his favour. In the event of a guarantee contract, the surety has substantially greater powers, including the ability to act in the place of the creditor and the ability to sue the primary debtor once the surety's responsibilities have been discharged.

Finally, the contract of guarantee must be in writing in order to be legal under English law. In the event of an indemnity contract, however, indemnification can be given orally or in writing. In Indian law, however, there is no such distinction, and both indemnity and bailment contracts can be either oral or written.[26]

The difference between the two types of contract can be summarized as:[27]

- In an indemnity contract, there are two parties: the indemnifier and the indemnity holder. However, in a guarantee contract, three parties are involved: the creditor, the principal debtor, and the surety.
- Number of Contracts: Because there are only two parties in an indemnity contract, there is only the possibility of one contract. A guarantee contract, on the other hand, comprises three subcontracts. Because an indemnity contract has two parties and a single contract, it may be described as simple in nature. However, because a guarantee

[24] State Bank of India v. MulaSahakariSakharKarkhana, Appeal (Civil) 2801 of 2006.
[25] Indemnity Laws in India, accessible at: https://blog.ipleaders.in/laws-indemnity/, last accessed on June 22, 2021.
[26] Id.
[27] Ibid at 22.

contract involves three parties and three subcontracts, it may be stated that it is complicated.

- Liability: There will be two sorts of liabilities in a guarantee contract: primary and secondary obligations, which will be with the principal debtor and surety, respectively. However, there is no categorization or sharing of blame in an indemnity contract, and the indemnifier bears whole responsibility.
- Recovery: In the case of an indemnity contract, the indemnifier cannot collect the money from anybody after compensating the indemnity holder for their loss. In a guarantee contract, however, if the surety pays the creditor, he (surety) can collect the money from the primary debtor.
- Parties' interests: An indemnity contract is constructed around the interest of the indemnifier, whereas a guarantee contract is formed around the interest of the primary debtor.

The differences for brevity are tabulated as below[28]:

S. No.	**Basis of Difference**	**Indemnity**	**Guarantee**
1.	Number of parties	There are 2 parties- indemnifier and indemnity holder.	There are 3 parties- surety, principal debtor and creditor.
2.	Number of contracts entered	Only one contract entered into between the parties.	Three contracts are entered into. First, principal debtor and creditor. Second, creditor and surety. Third, principal debtor and surety.
3.	Objective of the contract	The main aim is to protect the promise against some likely loss.	The main objective is the security of the creditor.
4.	Liability	The indemnifier's liability is primary. It only occurs when the promisor or	Suretyship is a secondary liability. When the primary debtor defaults, this situation

[28] Critical Analysis of Difference between Contract of Indemnity and Contract of Guarantee, accessible at: https://lawtimesjournal.in/critical-analysis-of-difference-between-contract-of-indemnity-and-contract-of-guarantee-under-the-indian-contract-law/, last accessed on June 22, 2021.

		another individual has caused the promisee some sort of loss.	develops.
5.	Recovering the amount paid	The indemnifier cannot collect the money from anybody once he has indemnified the indemnity holder.	After the surety has discharged the primary debtor's responsibility, he can seek reimbursement from the principal debtor for the amount he paid to the creditor.

CONCLUSION

As a result of the foregoing discussion, both a contract of indemnity and a contract of guarantee are means by which the other party is compensated/secured in the event of a default by the promisor in the case of a contract of guarantee and the promisor or any other party in the case of a contract of indemnity. Both are based on the principles of avoiding unfair enrichment and acting in good faith.[29]

There are several distinctions between an indemnity contract and a guarantee contract. Two parties are involved in an indemnity contract, whereas three parties are involved in a guarantee contract. Second, in an indemnity contract, the indemnifier's duty and obligation are main, but in a guarantee contract, the surety's responsibility and obligation are secondary. Other distinctions include the amount of contracts involved, the aim and purpose of the contracts, and so on. However, both a contract of guarantee and a contract of indemnification are designed to provide the promisee a sense of security, and both are ineffective in assuring benefits to both contracting parties in terms of reimbursements, monetary advantages, and so on.

An indemnity, on the other hand, allows for concurrent obligations with the principle despite the fact that there is no compelling reason to “look first” at the principal. In general, it is an agreement between the surety and the lender that the surety would hold the lender harmless from any calamities arising from the agreement between the principle and the lender. In most cases, a guarantee includes a far-reaching responsibility in addition to the principal's. After all, the guarantor can't be held liable for much more than the customer. If the surety's commitments

[29] Difference between Indemnity and Guarantee, accessible at: https://commerceiets.com/difference-between-indemnity-and-guarantee/, last accessed on June 22, 2021.

are to "stay behind" the principal and only come to the fore once a promise between the principal and the lender has been violated, the instrument will be seen as a guarantee. The commitment is incidental and reflexive in nature. An indemnity arises in the case of an occurrence, but a guarantee arises in the event of a third-party default. As a result, we've discussed what indemnification and guarantee are and how they differ, such as the number of parties involved and the nature of the risks involved, as well as the tiny but important variations in how they function and in principle between the two. As a result, while there are some parallels between guarantee and indemnity, they are fundamentally distinct.