

**LL. M. III SEMESTER**  
**Business Law Group**  
**Specific Contract**  
**CODE- L-3006**

**CONTRACT OF INDEMNITY: DEFINITION, NATURE,  
EXTENT AND COMMENCEMENT OF LIABILITY**

According to Longman's Dictionary of Contemporary English- "indemnity is protection against loss, especially in the form of a promise to pay or payment for loss of money, goods etc."

It is a security against, or compensation for loss etc.<sup>1</sup>(Chambers New English Dictionary)

According to Chitty<sup>2</sup> ----- The term indemnity is used the law in several different cases. In its widest sense it means recompense for only loss or liability which one person has incurred , whether the duty to indemnity comes from an agreement or not. For example , where a breach of contract arise gives to a claim for damages, that may include a claim to be indemnified against some loss or liability.

Under English law, " an indemnity is a contract, express or implied to keep a person, who has entered into or who is about to enter into, a contract or incur any other liability, indemnified against loss, independently of the question whether a third person makes a default."<sup>3</sup>

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<sup>1</sup> BANGIA Dr. R.K., CONTRACT-II, Allahabad Law Agency, Reprinted. 2014 p -1

<sup>2</sup> Chitty on Contract 23<sup>rd</sup> Edition Vol. II, p. 771.

<sup>3</sup> Halsbury Laws of England , Vol. 15, para 870.

In **Adamson v. Jervis**<sup>4</sup>, the plaintiff, an auctioneer, sold certain cattle on the instruction of the defendant. It subsequently turned out that the livestock did not belong to the defendant, but to another person, who made the auctioneer in his turn sued the defendant for indemnity for the loss he had thus suffered by acting on the defendant's directions.

The court laid down that the plaintiff having acted on the request of the defendant was entitled to assume that, if, what he did, turned out to be wrongful, he would be indemnified by the defendant.<sup>5</sup>

In English Law indemnity means a promise to save a person harmless from the consequences of an act. The promise may be express or it may be implied from the circumstances of the case.

In **Dugdale v. Lovering**<sup>6</sup>, certain trucks were in possession of the plaintiff. The defendant as well as a company claimed them. On the demand of delivery of trucks by the defendants, the plaintiff demanded an indemnity bond, but no reply was received yet they delivered the trucks to the defendants. Subsequently the said company (K.P. Co.) sued the plaintiff for conversion of property and succeeded in the suit. It was held that the defendants were liable to indemnify the plaintiff for in the opinion of the Court the demand of indemnity bond led to the creation of an implied promise.

In **Sheffield Corp. v. Barclay**<sup>7</sup> the Court held:

“Where a person invested with a statutory or common law duty of a ministerial character is called upon to exercise that duty on the request, direction or demand of another..... whether any default on his own part acts in a manner which is apparently legal but is, in fact illegal and

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<sup>4</sup> (1827) 4 Bing 66: 29 RR 503.

<sup>5</sup> Singh Dr. Avtar, Contract & Specific Relief, Eastern Book Company, 12<sup>th</sup> Edition 2017 (Reprinted) 2020 p.591

<sup>6</sup> (1875) LR 10CP 196

<sup>7</sup> 1905 AC 392

breach of the duty, and thereby incurs liability to third parties , there is implied by law a contract by the person making the request to keep indemnified the person having the duty against any liability which may result from such exercise of the supported duty.”<sup>8</sup>

**According to Sec. 124 of Indian Contract Act, 1872**, a contract of indemnity means- 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 conduct of any other person.

This provision incorporates a contract where one party promises to save the other from loss which may be caused either.—

- (1) By the conduct of the promisor himself or
- (2) By the conduct of any other person

Illustration :- A contract to indemnify B against the consequences of any proceedings which may take against in respect of a certain sum of Rs.200. This is a contract of indemnity.

**Indemnifier-** The person who promises to indemnify or bear the loss

**Indemnified or Indemnity holder-** The person for whose protection it is given or the person in whose favor such a promise is made.

**Essentials of Contract of Indemnity.**

- 1- Two parties in the contract – Indemnifier and Indemnified or Indemnity holder
- 2- Security or protection against loss.
- 3- The contract of indemnity may be express or implied.
- 4- Essentials of a valid contract i.e., competent of parties, free consent, lawful object & lawful consideration.

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<sup>8</sup> Kapoor Dr. S.K., Contract II, Central Law Agency, Thirteenth Edition 2012 p.1& 2

- 5- It covers only the actual loss.
- 6- The loss must be caused either by the promisor or by any other person.

### **Insurance indemnity**

Almost all insurances other than life and personal accident insurance are contracts of indemnity. The insurer's promise to indemnify is an absolute one. A suit can be filed immediately upon failure of performance, irrespective of actual loss. If the indemnity holder incurred liability and that liability was absolute, he would be entitled call upon the indemnifier to save him from that liability by paying it off.<sup>9</sup>

### **Extent of liability**

#### **Sec. 125 Rights of indemnity holder when sued.**

The indemnity holder, acting within the scope of his authority, is entitled to recover the following amounts--

- (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 authorized 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

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<sup>9</sup> New India Assurance Co Ltd v. State Trading Corp. of India , AIR 2007 NOC 517 (Gujrat), see in Singh Dr. Avtar, Contract & Specific Relief ,Eastern Book Company, 12<sup>th</sup> Edition 2017 (Reprinted) 2020 p.594

promisee to make in the absence of any contract of indemnity, or if the promisor authorized him to compromise the suit.

**Commencement of liability-** There has been a difference of opinion between various High Courts in India as to whether the indemnity-holder can claim indemnity before he has actually suffered the loss.

According to the view expressed by the Lahore<sup>10</sup> and Nagpur<sup>11</sup> High Courts, a person must be demnified before he can be indemnified, i.e., no indemnity can be claimed until the indemnity-holder had already actually suffered the loss.

The High Courts of Bombay<sup>12</sup>, Calcutta<sup>13</sup>, Madras<sup>14</sup>, Patna<sup>15</sup>, and Allahabad<sup>16</sup> have expressed a different view, and they are in favour of the application of law similar to the one recognized in England by the Court of Equity. According to the decisions of these courts, an indemnity-holder can compel the indemnifier to indemnify even before the indemnity-holder has actually suffered the loss.

Referring to the equitable principle and also the desirability of its being followed in India, Chagla, j. while delivering the judgment in the Bombay High Court decision of **Gajanan Moreshwar v. Moreshwar Madan** observed:<sup>17</sup>

“The Court of equity held that if his (indemnity-holder’s) liability had become absolute, then he was entitled either to get the indemnifier

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<sup>10</sup> Shyam sunder v. Chandu Lal, A.I.R. 1935 Lahore 974.

<sup>11</sup> Ranganath v. Pachusao, A.I.R. 1935 Nag. 117.

<sup>12</sup> Gajanan Moreshwar v. Moreshwar Madan, A.I.R. 1942 Bom. 302 A different view was expressed by this Court in its earlier decision, Shankar v. Laxman, A.I.R. 1940 Bom. 161.

<sup>13</sup> Prafulla Kumar v. Gopee Ballabh Sen I.L.R. (1944) 2 Cal. 318.

<sup>14</sup> Ramaligna v. Unnamolai, 38 Mad. 791.

<sup>15</sup> Chuni Bai v. Nathu Bai, 22 Pat 655.

<sup>16</sup> Abdul Majeed v. Abdul Rashid, A.I.R. 1936 All. 598.

<sup>17</sup> AIR 1942 Bom. 302

to pay off the claim or to pay into Court off the claim whenever it was made ... I have already held tha Ss. 124 and 125 Contract Act, are not exhaustive of the law of indemnity and the Courts here would apply the same equitable principle that the Courts in England do. Therefore, if the indemnified has intitled to cell upon the indemnifier to save him from that liability and to pay it off.”

The Law Commission of India has expressed the opinion that “the view expressed by Chagla, J. is corret and should be adopted by the legislature.”<sup>18</sup> The Law Commission recommended that as in English law , “ the right of the indemnity-holder should be indicated even in cases where he has not been sued.”

In **State Bank of India v. Mula Sahakari Sakhar Karkhana Ltd.**,<sup>19</sup> the respondent , a co-operative society, having a sugar factory, entered into a contract with one M/s Pentagon Engineering Pvt. Ltd. for the installation of a paper plant. As per the agreement the pentagon furnished a Bank Guarantee/Indemnity for the release. The retention money of 10% from the proforma Invoices of the material reached at the site. The operative portion of the Bank Guarantee read as” to indemnify and keep indemnified Mula Sahakari Sakhar Karkhana Ltd. against all losses claims damages actions and cost in respect of such sums which the supplier shall become liable to pay as the terms of the said order.”

Disputes and differentces arose between the parties and as a result, the respondent terminated the contract and invoked the Bank Guarantee against the pentagon. Holding that the document indemnifying the respondent was a contract of indemnity and not guarantee, the Apex

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<sup>18</sup> 13<sup>th</sup> Report on Indian Contract Act, 1872 at 51 & 52.

<sup>19</sup> AIR 2007 SC 2361

Court said that the claim made by the assured on termination of contract need not be honoured by the Bank without the proof of loss<sup>20</sup>.

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<sup>20</sup> BANGIA Dr. R.K., CONTRACT-II, Allahabd Law Agency, Reprinted. 2014 p -5&6