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Contract of Indemnity Case Laws

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Abstract: ***The phrase indemnity says "security against loss". A contract of indemnity is a part of 'contingent contract'. A form of contractual obligation made between the parties, in which one of the party (indemnifier) agrees to pay for the loss or damages suffered by the other party (indemnified) or may occur, is said to be indemnified. Indemnity is a mere motivational tool. The main objective of entering into is the such contract is the protecting the promisee against the anticipated loss. The whole contract of indemnity depends upon the contingency of the happening of the loss or damage. In contract of indemnity the primary liability falls upon the indemnifier (promisor). A contract of indemnity is one of the species of contract. The contract of indemnity or indemnity clause can often be seen in cases of agreement between the tenants and landlords, suppose, a house is given for rent to a tenant. Some electric and holding charges are not paid being the original owner (the landlord). Now, the tenant has paid the charges in good faith, here the indemnity is not applied but implied indemnity is done***

1. Introduction

The literal meaning of the term 'Indemnity' means 'Security against loss'. The contractual obligation over one party to compensate the loss or damages occurred to the other party or may occur in the future, caused by the act himself or any other party, is said to be indemnified.

It can also be defining as *"a duty to make good any loss damage or liability incurred by another", or alternatively "the right of an injured party to claim reimbursement for its loss, damage or liability from a person who has such duty"* [1].

A contract of indemnity is an express promise or is a voluntary obligation done or taken to ensure that a contracting party suffering the loss or damage defined, has an express remedy under the contract to rectify the defects in the goods or services.

According to the English Law definition of contract of indemnity is - "a promise that a person is saved harmless from the consequences of an act". Under English law it is not necessary that only such loss that are due to the conduct of a person but also, the loss caused by fire or by some other accidents beyond one's control, thus has wide scope of application to be included in a promise of indemnity against all losses arising from any cause whatsoever under the English law. Indeed, other than life insurance every contract of insurance is a contract of indemnity [2].

According to the Indian Contract Act, 1872, Section 124 which provides that "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'." It basically comprises of two parties:

- Indemnifier
- Indemnified Or Indemnity-Holder

Indemnifier (promisor), the person who make good the loss, whereas indemnity-holder (promise), is the person whose loss is to be made good.

Suppose, K contracts to L. According to which K has to sell a plot to L after 6 months. A week later L approached K and insisted on selling him the same plot to him(L). Now, L promising to compensate for all loss occurring to K, due to the selling of the plot.

Here, the contract forming between K and L is called Indemnity, where K stands as indemnifier and L is the indemnity holder.

2. Nature of Contract of Indemnity

A contract of indemnity sets out to be both express as well as implied promises depending upon certain circumstances of the case. However, implied indemnity seems not to be covered under Section 124 of the Indian Contract Act. Express indemnity, is a written agreement where the term and condition are such that the concerned parties abide are usually indicated e.g. insurance indemnity contracts, construction contracts, agency contracts etc. On the other hand, Implied contracts is obligation to indemnify that are not in the written form but arises from certain circumstances or by the conduct of the parties involved e.g. agent-principle business relationship.

SECRETARY OF STATE vs. THE BANK OF INDIA [3],where a government promissory note was endorsed by a Broker, with false endorsement. Acting in good faith bank applied for and got renewed a promissory note from the Public Debt Office. In the meanwhile, the Secretary of State was sued by the true owner for conversion. In turn Secretary of State, sued the bank on the basis of implied indemnity. Held, general principle of law; when an act done by a person in request of another which act is not manifestly tortious in itself to the knowledge of the person doing it and such act turns out to be injurious to the third person, then that person doing it is entitled for indemnity by the person who request that act has been done.

More obviously, the cases of implied indemnity are bargained in the Indian Contract Act, 1872, under the Section 69, Section 145 and Section 222.

3. Some Special Cases of Implied Indemnity

- Under Section 69, "a person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to reimbursed by the other".
- Section 145, provides "in every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety; and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but no sums which he has paid wrongfully".
- Section 222, given that "the employer of an agent is bound to indemnify him against the consequences of all lawful acts done by such agent in exercise of the authority conferred upon him".

a) Indemnity And Damages

There should always be a distinguished line between the right to indemnity given by the original contract and the right to damages arising from the breach of contract [4]. While the right of the indemnity comes off by the original contract, the right to damages arises from the consequences of the breach of that contract. The right of indemnity comes under Section 124 of the Indian Contract act 1872 while the right to damages is provided under Section 74 of the same act. The two rights are often puzzled and the reason for the confusion is whenever the contract is broken, indemnity is often found to concur with measure of damages [5]. In the case of Supra, there was a minor daughter work in a company for which her mother agreed, failing which the mother and daughter would compensate the company for the loss suffered by it, in lieu the money was for the damages for breach and not indemnity. Thus, it was not a contract of indemnity [6].

b) Liablity In Tort

There are two category of indemnity clauses:

Firstly, in which one party to the contract agrees to indemnify against all the liability in tort to the other party. The best illustration for this kind of contract is by using the "knock for knock" principle, where the parties agrees to reciprocal or mutual indemnities covering such liability. Several forms of liability can come under this category. The liability that one party has incur to the third party. Suppose for instance, there is a construction contract, let say A agrees to indemnify B. In the commercial building A is hired to do tile work, and as the tile work turns out to be defective, B immediately incurs liability towards the owner.

Second form of liability is where one party agrees to indemnify for all liabilities against another party which may be incurred to the other party by the third party. This case has various resemblances with guarantees, but as stated the obligation to indemnity must be distinguished from the obligation of guarantee

Illustration: In the case of Yeoman Credit Ltd. v. Latter [7], a finance company let a car on hire-purchase to the first defendant who is an infant. The second defendant (his father) signed a form headed "hire-purchase indemnity and undertaking". The issue was whether this document was an indemnity or was guarantee. A guarantee would be void in this case reason, it guarantees a void contract. On the other hand, an indemnity would be enforceable, being the fact that the debtor was a minor hence, would not be provided a defence against the primary liability to indemnify. The court held that "an indemnity contract by which one party to keep the harmless against loss and damage" but contract of guarantee on the other hand is a contract to answer the debt of another who is to be primary liable to the promise [8].

4. Legal Effort of Indemnity Clause

Several legal effects are intended in the indemnity clause which can be seek to achieve by the contracting parties. In several ways it can be true to say that the contractual purpose of indemnity is to amend the legal regime within which the contract operates.

- Risk allocation
- Remoteness and mitigation
- Negligence

a) Risk allocation

One of the basic function of contracts of indemnity is risk allocation, it enables the parties to allocate the risk involved between them in advance. It is already held by the court that all commercial parties must be left free to decide how they can allocate the commercial risk. The indemnity clause is used as a contractual provision to attempt a distribution in such risk arising thereto by the transaction.

b) Remoteness and mitigation:

Under Common law, remoteness and mitigation are rules which are related to damages. Here the question arises that 'Whether or not are these rules also applicable to indemnity, thereby affecting the extent upon what the party can be entitled to be indemnified?'.

Not a lot of authority particularly on this issue is available, but on triggering the indemnity in the event of breach of contract, the court of appeal has two decisions on interest. In Royscot Commercial Leasing Ltd v. Ismail [9] a director had provided an indemnity in order to support an equipment which is lease granted to his company. Further, the director argued that the lessor would have mitigated the loss with follow of a default by the lessee. It was held that "under the contract of indemnity a claim is not a claim for damage at all, but it is a claim over the debt for a special sum due upon the happening of an event which has occurred". Also, the argument was rejected on this basis only.

c) Negligence:

There is a development in some specific rule of construction done by the court, so that the case dealing with the provision which attempts to exclude a party's liability for its own negligence. A three-tier test for such clause of rule of construction was formulated. It is provided for the construction of the indemnity clause that "if a person is obtaining an indemnity against the consequence of certain acts, then the indemnity clause is not to construed so that they can include the consequence of there own negligence to the extent that their negligence is covered by some other consequence **[10]**.

The three-tier test may be applied to the indemnity provision.

Suppose, as founded in the case of E.E Caledonia limited v. Orbit Vavle Co. in the drilling platform a very disastrous fire occurred, which was caused due to the negligence and the breach of the statutory duty which were to be performed by the operator's employee's, it turns out as the result of the death off the contractor's engineer. The operator seeks an indemnity from the contractor. However, the court foresee that the indemnity clause didn't cover the part of negligence. Further, as the claimant has already sought for the indemnity, so that he can c=be indemnified against the consequences caused on the ground of negligence, while these grounds were fanciful and remote. Thus, held that indemnity clause is not profound to cover negligence.

5. Some Important Case Laws

1) Gajan Moreshwar Parelkar vs. Moreshwar Madan Mantri [11],1942:

The plaintiff entered into an agreement with the Municipal corporation for the lease of a plot of land. The plaintiff in pursuance of the agreement was put in possession of that plot of land. There upon, the possession of the plot and the commenced to erect a building thereon was entered by the defendant. The construction material for the building was supplied by a person called Keshavdas Mohandas and therefore, the amount exceeds Rs.5000. Keshavdas Mohandas made pressure demand over the defendant for the payment of that amount, while at the request of the defendant the plaintiff mortgage the property to Keshavdas Mohandas to secure payment of a sum of Rs.5000 by depositing the title deed relating thereto. The plaintiff covenant under the terms of writings to pay off the sum of Rs.5000 to Keshavdas Mohandas and interest at the rate of ten annas per Rs.100. Again, the plaintiff at the request of the defendant effected a further charge on the property favoured to Keshavdas Mohandas to secure a further sum of Rs.5000 and thereon interest. Under this the interest was same as the previous writing. The defendant to the plaintiff stating in writing that in context with the building transferred in the defendant's name by the plaintiff, the defendant would be responsible for discharging the mortgage on the same. The plaintiff on good faith acts upon the request of the defendant wrote a letter asking the Bombay Municipal to transfer the plot of land to the name of the defendant. The plaintiff failed to procure a release of the plaintiff from his liability under the mortgage and further charges from Keshavdas Mohandas. The plaintiff filed a writ petition stating that he has executed the mortgage and the deed further charges on the request of the defendant and therefore the defendant is liable to indemnify the plaintiff. Therefore, he prays to the court to procure the defendant for release of the plaintiff from all the liability the mortgage and the further charges. Further the defendant raised only two issues:

- Whether the plaint discloses any clause of action?
- Whether the suit was premature?

Mr. Tendolkar for the defendant argues that unless and until the indemnified has suffered a loss or damage for which he is no entitled to sue the indemnifier. Also, according to him, the case does not contain any averments in the plaint that the plaintiff as suffered actual loss or damage.

"The Indian Contract Act is both amending as well as consolidating Act and is not exhaustive of the law of contract to be applied by the courts in India". The court didn't accept the defendant instance that the plaintiff has not any loss and thus couldn't claim. The court said that if indemnity-holder has incurred a liability and the liability is absolute, then he can to the indemnifier to take care of it. Hence, the plaintiff was indemnified by the defendant for all those liabilities under the mortgage and deed of further charges.

2) Adamson vs. Jarvis [12]

The plaintiff, is an auctioneer who sold certain cattle on the instruction of the defendant. It subsequently learned out that the livestock sold was not owned by the defendant but belonged to another person who made the auctioneer (plaintiff) liable for the conversion. The auctioneer in turn sued the defendant for indemnity for the loss and damage suffered by him while acting the defendant's direction. The court laid down that the plaintiff has acted upon the request of the defendant and was entitled to presume that if anything went wrong he would be indemnified. Hence, the defendant was order to indemnify the loss and damage to the plaintiff.

3) Osman Jamal and Sons Ltd. vs. Gopal Purshottam [13]

In this case the plaintiff company was in liquidation. Represented by the official liquidator. The plaintiff company was acting as the commission agent for the defendant firm for the purchase and sale of certain goods. Further the defendant firm would indemnify the plaintiff company against all loss and damage in respect of such transaction. The defendant firm failed to take the delivery, as a result the goods were resold by the vendor at less than the contract price. Under the aforesaid indemnity by the defendant, the plaintiff consequently seeks for the recovery of the sum. It was held that the amount could be recoverable to then Official Liquidated even though the company had not actually paid the vendor.

This type of case seems to fall under the category where the indemnity is with the application of money which he pays. In turn the defendant may be liable for undisclosed principle, it will result unjust in case if after paying the full amount claimed the vendor would receive only a dividend.

According to Kennedy L.J, he say that "the authority to hold this view in the court of Equity to indemnify merely does not only mean to reimburse in respect of the paid money, but also to save in respect from loss all liability against which the indemnity stands".

Thus, there is a decree in favour of the plaintiff.

6. Analysis

Indemnity is the sub- species of compensation while as mentioned above the contract of indemnity is the species of contract. This obligation is a voluntary obligation which is

taken by the indemnifier, it totally depends on the will of the promisor. The definition of indemnity as stated in section 124 is not very exhaustive. It is set out that the section talks about the case which has a expressed contract of indemnity but in actual the implied contract of indemnity is thereto, which is well-recognised in the case of SECRETARY OF STATE vs. THE BANK OF INDIA assured by the Privy Council. Also, one is indemnified only when the loss as occurred and not mere on the possibility of happening of loss or damage. Plus, it must be act done by the indemnifier and the person act in his behalf. My opinion that indemnifier should not always be held liable specially in action of natural cause as well as remote acts. On the rigid nature it does not take into consideration the acts of God. Here, the individual is only liable to take care of the liability which is expressed and implied. And if in case the indemnifier is charged for the unforeseen damages then it will be unjust.

In insurance the liability has a wider scope than that of the liability of the indemnity.

It is also critical to understand the limitation period or let's say the duration of the indemnity clause.

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