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Of Risk and Rescue: A Juridical Analysis of the Contract of Indemnity under Indian Law

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ABSTRACT

A contract of indemnity is foundational to the law of obligations and insurance. Rooted in the broader concept of compensatory justice, the contract of indemnity under Indian law—defined under Section 124 of the Indian Contract Act, 1872—forms a crucial part of commercial transactions, risk allocation, and agency relationships. This paper critically examines the concept of indemnity, analyzing its scope, nature, enforcement mechanisms, judicial interpretation, and its interplay with common law. It also explores niche applications such as indemnity in contracts of insurance, agency, corporate guarantees, and employment law. Key judicial precedents are evaluated for their interpretative contribution.

KEYWORDS

Contract of Indemnity, Risk Allocation, Insurance Law, Agency Law, Corporate Guarantees, Employment Contracts, Judicial Interpretation, Compensatory Justice, Commercial Law, Common Law, Indemnifier, Indemnity Holder.

INTRODUCTION

Contracts of indemnity are foundational instruments in risk management and liability allocation in both commercial and civil jurisprudence. These contracts facilitate the redistribution of loss from the indemnitee to the indemnifier, ensuring security in commercial transactions, employment relationships, agency, and

public procurement. Under the Indian Contract Act, 1872¹ (ICA), the legal principles governing indemnity are codified, albeit in a form more limited than English common law. This paper offers a comprehensive legal analysis of the contract of indemnity under Indian law by examining statutory provisions, judicial interpretation, comparative insights, and its evolving commercial significance.

2. HISTORICAL EVOLUTION OF THE CONTRACT OF INDEMNITY

The roots of indemnity stretch back to Roman law, which developed the principle of *noxal surrender*, allowing a wrongdoer to offer restitution in lieu of punishment. With the progression of commercial practice in medieval Europe, merchants began to require legal assurances that they would not suffer loss from certain undertakings. This need birthed early insurance and indemnity practices.

English common law integrated the idea through judicial recognition, especially in the 17th century, in the form of implied obligations to indemnify. The famous case of *Adamson v. Jarvis* (1827) 4 Bing. 66 laid a cornerstone, recognizing that where one acts at the request of another, an indemnity is implied.

When British law was transplanted to India, indemnity entered the statutory fold through Section 124 and 125 of the ICA. While the Indian version remains narrower, it was influenced by both equitable principles and legislative economy, emphasizing indemnity from the acts of the promisor or third parties.

3. CONCEPT AND SCOPE UNDER INDIAN CONTRACT ACT, 1872

Section 124 defines a contract of indemnity 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.”

This definition offers a specific view of indemnity, confined to losses caused by human agency. It does not explicitly cover loss from accidents, natural events, or statutory liabilities.

¹ Indian Contract Act, 1872.

Key Elements of Section 124:

1. **Promise to Save:** It involves a unilateral or bilateral promise to protect against a defined loss.
2. **Loss Must Be Legal:** The loss should be legally recognized and not merely speculative.
3. **Conduct-Based Causation:** The statute restricts indemnity to losses caused by conduct—either of the promisor or another person.
4. **Exclusion of Acts of God:** Unlike English law, it does not include acts of nature unless implied.

Section 125 then defines the rights of the indemnity-holder when sued. However, the Act is silent on the timing of enforceability and whether indemnity is available before the loss is actually incurred—an issue clarified by Indian courts.

4. EVOLUTION THROUGH JUDICIAL INTERPRETATION

Given the statutory limitations, Indian courts have interpreted indemnity provisions to give them commercial efficacy.

Landmark Judgments:

- **Gajanan Moreshwar v. Moreshwar Madan²,** Justice Chagla held that it would be unjust to force the indemnified party to wait until actual loss is incurred. The court held that when liability becomes absolute, the indemnifier must step in—even before loss crystallizes.
- **Osman Jamal & Sons Ltd. v. Gopal Purshottam³,** The court held that indemnity could be implied, and the Indian Contract Act is not exhaustive. This opened the gates to recognize implied indemnities in agency, contracts, and partnerships.
- **United India Insurance Co. Ltd. v. M.K.J. Corporation⁴,** This case clarified that insurance contracts fall within the ambit of indemnity and that they are enforceable once the insured risk occurs, aligning Indian practice with international norms.

Thus, while the ICA gives a skeletal definition, courts have enriched its meaning, bringing Indian indemnity law in harmony with commercial needs and international principles.

² Gajanan Moreshwar v. Moreshwar Madan, AIR 1942 Bom 302.

³ Osman Jamal & Sons Ltd. v. Gopal Purshottam, AIR 1929 Cal 833.

⁴ United India Insurance Co. Ltd. v. M.K.J. Corporation, AIR 1996 SC 1557.

5. DISTINCTION FROM OTHER RELATED DOCTRINES

Indemnity must be distinguished from similar legal constructs that appear superficially analogous.

Aspect	Indemnity	Guarantee	Tort	Warranty
Nature	Contract to protect against loss	Tripartite obligation	Arises from duty of care	Contractual assurance
Parties	Two (Indemnifier & Indemnity-holder)	Three (Surety, Debtor, Creditor)	Involves plaintiff & tortfeasor	Seller and buyer
Loss	Loss is compensated	Default is guaranteed	Damages awarded for breach	Loss due to defective goods
Timing	Arises when loss is threatened or incurred	Arises when principal fails to perform	After wrongful act	After discovery of defect

These distinctions are critical, especially in drafting commercial contracts, where overlapping terminologies may cause unintended legal consequences.

5.1 Expansion of Scope Beyond Express Agreements

One of the landmark decisions in this regard is **Gajanan Moreshwar v. Moreshwar Madan**⁵, in this case, the Bombay High Court observed:

“If the indemnity holder has incurred a liability and the liability is absolute, he is entitled to call upon the indemnifier to save him from the liability and to pay it off.”

This marked a critical departure from the narrow reading of Section 124, which could otherwise be interpreted to mean that indemnity is enforceable only after the indemnity holder has suffered actual loss. The court ruled that once a liability becomes imminent or crystallized, even without actual payment, the indemnifier can be compelled to indemnify.

⁵ Gajanan Moreshwar v. Moreshwar Madan, AIR 1942 Bom 302.

5.2 Judicial Recognition of Implied Contracts of Indemnity

In **Osman Jamal & Sons Ltd. v. Gopal Purshottam**⁶, the Calcutta High Court accepted the existence of **implied indemnity**. The case involved the plaintiff who, as a consignor, was asked to take delivery of goods for which the bill of lading was missing. He did so under the defendant's request and later sued when litigation arose.

The court held that even without a formal contract, the facts gave rise to an implied indemnity. This judgment was instrumental in aligning Indian law with the broader equitable doctrines recognized in English common law and commercial customs.

5.3 Director and Officer Indemnities and Employment Context

In **Satya Narain v. Union of India**⁷, the Delhi High Court addressed the issue of contractual indemnity for public servants. The court held that indemnity clauses protecting government employees from the consequences of lawful acts performed in the course of employment are valid, provided they do not contravene public policy.

This judgment has significant relevance in today's employment law, especially in sectors like banking, government contracts, and public service where indemnity for lawful professional acts is essential to ensure functional independence and avoid vexatious litigation.

5.4 Indemnity in Commercial Risk Allocation

In **Bank of Bihar Ltd. v. Damodar Prasad**⁸, the Supreme Court clarified that indemnity provisions in commercial contracts are not only enforceable but also central to the fair allocation of risk. The indemnifier's liability is not suspended until actual loss is proven; instead, it arises as soon as the principal debt or liability becomes enforceable.

5.5 Public Contracts and Damages

The Court held that even without a form an **Oil and Natural Gas Corporation v. Saw Pipes Ltd.**⁹, the Court emphasized that indemnity clauses in public contracts must be construed strictly,

⁶ Osman Jamal & Sons Ltd. v. Gopal Purshottam, AIR 1929 Cal 833.

⁷ Satya Narain v. Union of India, 2013 SCC OnLine Del 4115.

⁸ Bank of Bihar Ltd. v. Damodar Prasad, AIR 1969 SC 297.

⁹ Oil and Natural Gas Corporation v. Saw Pipes Ltd., (2003) 5 SCC 705.

particularly where public interest is involved. Yet, it upheld the enforceability of liquidated damages clauses that served an indemnity-like purpose by compensating the employer for the contractor's delay.

6. RIGHTS OF THE INDEMNITY HOLDER

Section 125 of the ICA outlines the rights of the indemnity holder, which include:

1. **Right to recover damages** the holder may be compelled to pay in any suit concerning the indemnity.
2. **Right to recover legal costs**, provided they were incurred prudently and with the promisor's authority.
3. **Right to recover sums paid under compromise**, again subject to prudent action and no contrary instructions.

These rights ensure that the indemnity holder is not left financially vulnerable, whether or not the loss has materialized. Judicial decisions like *Gajanan Moreshwar* have further clarified that these rights can be invoked as soon as liability becomes probable, not necessarily realized.

7. JUDICIAL INTERPRETATION AND PRECEDENTS

Several important cases in Indian jurisprudence have deepened the understanding of indemnity:

- **State Bank of India v. Mula Sahakari Sakhar Karkhana Ltd.**¹⁰, The court upheld the right of a bank to be indemnified when the guarantee it gave was invoked.
- **Sham Sunder v. State of Punjab**¹¹, Emphasized that while indemnity clauses are subject to strict interpretation, they should be enforced in line with commercial expectations.
- **New India Assurance Co. Ltd. v. Kusumanchi Kameshwari**¹², Recognized that insurer liability under indemnity arises as soon as the insured event occurs, regardless of when payment is made.

8. INDEMNITY IN NICHE LEGAL CONTEXTS

Contracts of indemnity extend far beyond textbook theory; their operation can be observed in a wide range of modern legal contexts. While Sections 124 and 125 of the Indian Contract Act

¹⁰ State Bank of India v. Mula Sahakari Sakhar Karkhana Ltd., AIR 2006 SC 2360.

¹¹ Sham Sunder v. State of Punjab, AIR 1974 SC 543.

¹² New India Assurance Co. Ltd. v. Kusumanchi Kameshwari, (1999) 9 SCC 613.

provide the foundational framework, their practical relevance surfaces most vividly in nuanced domains of law.

8.1 Insurance Contracts

Insurance is the most widely recognized form of an indemnity agreement. In a contract of insurance (excluding life insurance), the insurer promises to indemnify the insured against losses resulting from specified risks.

- **Nature of Indemnity in Insurance:** The indemnity principle ensures that the insured is restored to the original financial position before the loss, without gaining profit.
- **Judicial Endorsement:** In *New India Assurance Co. Ltd. v. Harshadbhai Amrutbhai Modhiya*,¹³, the Supreme Court reaffirmed that general insurance contracts are pure indemnity contracts.
- **Statutory Backing:** The Insurance Act, 1938 complements indemnity principles by regulating contracts to prevent speculative gains.

The doctrine of subrogation and contribution within insurance law also derives from indemnity logic, ensuring that compensation is just and not duplicative.

8.2 Corporate and Commercial Guarantees

In commercial transactions, indemnity clauses are often embedded in partnership agreements, mergers, and loan documentation.

- **Transactional Role:** Indemnities protect parties from breach of representations, third-party claims, and tax liabilities.
- **Case Illustration:** In *Bank of Bihar Ltd. v. Damodar Prasad*¹⁴, the Supreme Court observed that corporate indemnities are enforceable without prior actual loss if the liability is imminent.
- **Usage in M&A:** During mergers, indemnity provisions allocate risk between buyer and seller for contingent liabilities, regulatory breaches, or environmental risks.

8.3 Agency Relationships

Section 222 of the Indian Contract Act states that a principal must indemnify an agent for lawful acts done in execution of authority.

¹³ *New India Assurance Co. Ltd. v. Harshadbhai Amrutbhai Modhiya*, (2006) 5 SCC 192.

¹⁴ *Bank of Bihar Ltd. v. Damodar Prasad*, AIR 1969 SC 297.

This makes indemnity an essential part of agency law.

- **Scope:** The indemnity extends to both acts and omissions done in good faith under express or implied instructions.
- **Relevant Case:** In *Adamson v. Jarvis*¹⁵, the agent was indemnified after he sold cattle under the mistaken belief that the owner had given authority.

The principle ensures that agents do not bear undue personal risk when acting under the direction of the principal.

8.4 Employment and Service Contracts

Many employment contracts—especially for directors and officers—contain indemnity clauses to protect from litigation arising from official acts.

- **Directors' Liability:** Under corporate governance frameworks like the Companies Act, 2013, indemnification is allowed for legal costs arising from suits, except where the officer has been found guilty of fraud or misconduct.
- **Judicial Viewpoint:** In *Satya Narain v. Union of India*¹⁶, the court acknowledged contractual indemnities in employment contracts, subject to reasonableness and public policy.

Such indemnities enhance managerial efficiency by allowing decisions without fear of personal litigation.

8.5 Government Contracts and Public Procurement

Government contracts frequently contain indemnity clauses aimed at shifting responsibility to private contractors.

- **Example:** Public-private partnerships (PPPs) often require private entities to indemnify the government against project delays, cost overruns, or third-party claims.
- **Precedent:** In *Oil and Natural Gas Corporation v. Saw Pipes Ltd.*¹⁷, the Supreme Court enforced such indemnity clauses, emphasizing their deterrent value.

This prevents undue burden on public funds and ensures accountability in public works.

9. COMPARATIVE LEGAL ANALYSIS WITH ENGLISH COMMON LAW

A comparative study reveals that Indian indemnity law is

¹⁵ *Adamson v. Jarvis* (1827).

¹⁶ *Satya Narain v. Union of India*, 2013 SCC OnLine Del 4115.

¹⁷ *Oil and Natural Gas Corporation v. Saw Pipes Ltd.*, (2003) 5 SCC 705.

narrower in statutory formulation but flexible through case law evolution.

Comparative Table

Aspect	Indian Law (ICA)	English Common Law
Definition	Limited to human conduct (Section 124)	Broad; includes events beyond human acts
Timing of Enforcement	Traditionally after actual loss; now possible upon accrual of liability	Can be invoked upon threat or potential liability
Types of Indemnity	Express and implied recognized judicially	Express, implied, and statutory indemnities
Scope	Does not cover acts of God unless implied	Includes losses from natural events, obligations imposed by law
Case Law Foundation	<i>Gajanan Moreshwar, Osman Jamal</i>	<i>Adamson v. Jarvis, Birch v. Cropper</i>

Thus, Indian courts have progressively harmonized indemnity enforcement with English principles, despite statutory textual limits.

Implications of the Comparative Analysis

- **Indian Legal Evolution Is Judicially Driven:** The evolution of indemnity in India has been predominantly case-law driven due to a narrowly drafted statute. Courts have adapted the principle to modern settings, such as indemnity in cyber contracts or government procurements.
- **Need for Codified Reform:** Unlike English law where common law principles suffice, India requires legislative action to resolve uncertainties, especially around indemnity enforcement, coverage of non-human events, and statutory obligations.
- **Legal Certainty for Commercial Players:** The gap between judicial interpretation and statutory law in India creates uncertainty for foreign investors and MNCs. Harmonizing Indian indemnity law with English/common law standards

can improve ease of doing business and contract enforceability.

10. CONTEMPORARY APPLICATIONS AND COMMERCIAL PRACTICE

Modern commercial practice extensively relies on indemnity contracts to structure risk and liability in cross-border transactions, joint ventures, finance, and software services.

Key Sectors Using Indemnity:

- **Technology Contracts:** Software licenses often include IP indemnity clauses to protect licensees against third-party infringement suits.
- **Construction and Infrastructure:** EPC (Engineering, Procurement, and Construction) contracts mandate indemnity for worker injury, environmental damages, or delays.
- **International Trade:** Under INCOTERMS, sellers often indemnify buyers for customs non-compliance, shipping loss, or documentation issues.

Real-World Example:

In 2020, Amazon Web Services (AWS) included comprehensive indemnity clauses in cloud service agreements, insulating itself from client-side misuse of the platform.

Indemnity today is no longer an auxiliary clause — it is a core device for legal risk management.

11. CRITIQUE AND SUGGESTIONS FOR REFORM

Despite its commercial utility, the Indian law on indemnity remains riddled with ambiguities:

Critique:

1. **Narrow Statutory Definition:** Limiting loss to "conduct" excludes many real-world losses, like cyber-attacks or force majeure events.
2. **No Guidance on Quantum:** There is no statutory method to calculate indemnity when damages are uncertain.
3. **Lack of Clarity on Timing:** The Act does not clearly state whether indemnity can be claimed upon incurrence of liability or only after loss.

Suggested Reforms:

- **Broaden Section 124** to include events like statutory penalties, environmental damages, or force majeure events.
- **Introduce a Schedule** to guide commercial indemnity drafting — like Singapore's Contracts (Rights of Third Parties) Act.
- **Codify Judicial Principles** from *Gajanan Moreshwar* and others to ensure clarity on enforcement.

12. CONCLUSION

The contract of indemnity, as regulated by the Indian Contract Act, 1872, has grown well beyond its textual constraints to become a pillar of modern commercial jurisprudence. Through robust judicial interpretation, indemnity law has been able to address practical challenges in agency, employment, corporate transactions, and government contracts. However, as commercial instruments become more complex and cross-border in nature, there is a pressing need to reform the statutory text to align with global standards and contemporary needs. For law students, practitioners, and lawmakers, the evolution of indemnity law is a living testament to the dynamism of legal interpretation and the need for constant recalibration.

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