CHAPTER – III

CHANGING TRENDS OF CONSIDERATION UNDER LAW OF INDEMNITY

Prelude

The researcher feels that before taking a dip in the movement of consideration for Indemnity and Guarantee, one should look in the need for doing so. Why there is a need to look into the movement aspect of the concept of consideration in contracts? The Law of Contract in India, which deals with the Contract of Indemnity, Contract of Guarantee and the Concept of Consideration has been mentioned under the Indian Contract Act, 1872; a legislation which has its roots in the English Common Law and has been borrowed from there. The legislation is old and came in force in India in the year, 1872 and still holds well in India. However, since the time of its enactment till today, commercial world has taken a gigantic leap in terms of volume, number, and aspirations of people. There have been new developments and modern trends in the law of contract which reflects the rapid transition of society. These modern developments, trends and aspirations of the people have also lead the judiciary to come up with judicial innovations by way of principles, doctrines etc. and a shift has also been felt in the judicial pronouncements. The judiciary has now become more sensitive in imparting justice to the parties by way of evolving new principles in the commercial world.

Therefore, it is necessary to see the gradual judicial progression in the Contract of Indemnity and Guarantee with respect to concept of consideration and its interpretation. Through case laws, the researcher would also look into the various parameters within which the concept of Indemnity and Guarantee are incorporated e.g. insurance, commercial transactions etc., and also study the developments and various recommendations made by the Law Commission of India for the said provisions of law. Simultaneously, the researcher would also see how far the Indian Contract Act, 1872 is able to keep up to the expectations of the changing world of the 21st

century. At some instances there may also be felt the need to suggest changes to resolve the conflicts.

In view of the researcher, movement of consideration for Indemnity and Guarantee has not been dealt in any of the articles so far. No one has laid stress on the manifestations of consideration, which occurs to the party in the Contract of Indemnity and the Contract of Guarantee. Therefore, it becomes a suggestive topic for the student of law, to pursue one’s research on the topic. At the outset, the topic might appear to be an inextricable confusion of foreign and domestic affairs; however, the friction needs to be resolved. The present chapter deals with the Contract of Indemnity and the aspects of Consideration in it under the Indian Contract Act, 1872.

3.1 REVISION OF INDIAN CONTRACT ACT, 1872

The researcher proceeds with the first and the only report of the Law Commission of India, from the year 1958 and an attempt is made to comprehensively analyze the Indian Contract Act, 1872 e.g. Contract of Indemnity as provided in Sections – 124 and 125 (dealt in the present chapter); Contract of Guarantee as given in Sections – 126 to 147 (dealt in the next Chapter, Chapter-IV) and Doctrine of Consideration under Section – 2(d) of the Indian Contract Act, 1872 and the various judicial innovations have been made in the last few decades on the Contract of Indemnity and Contract of Guarantee with special reference to the concept of consideration.

Law Commission of India, Thirteenth Report \(^3\) in the year 1958 had taken up for the revision of the Indian Contract Act, 1872; the Commission had attributed the revision of the Indian Contract Act, 1872 to the new developments that have taken place in the law of Contract since the time of coming into force of the Indian Contract Act in the year 1872. The Law Commission states that during the early times, land constituted one of the most important properties. Due to which the common lawyers of that time were greatly occupied with the land problems and they approached other problems also with the same bent of mind. They looked for certainty, no matter justice was delivered or not? However, by the nineteenth century, “freedom

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of contract was the governing principle.”

The gradual developments and transition in the law of contract had to be addressed by way of revision of the Contract Act, 1872. The Law Commission therefore, made an attempt to look into the developments in the law of contract in India since the time of its inception till the year 1958.

The Law Commission of India had taken up for the revision of the Contract Act, 1872, to study the various development and the modern trends taking place within and outside India with reference to law of contract. It had, together with the various opinions advanced by the jurists in different countries, has also looked into several recommendations made by committees/commissions in England and New York.

The Law Commission has come across various conflicting judicial pronouncements on various provisions of the Indian Contract Act, 1872, some of which require legislative changes. In an endeavor to resolve such conflicts and put them at rest, the law commission came up with the review of the Indian Contract Act, 1872 and has suggested changes in the provisions of the existing law.

The Law Commission has interpreted the preamble of the Act to mean that the Indian Contract Act, 1872 is not an exhaustive code and has cited Gajanan v. Madan case, in which it was held that “Sections 124 and 125 of the Act do not lay down the whole law of indemnity.”

The Law Commission of India is of the view that on matters on which the code/Act is silent the courts have to resort to the rules of English Common Law, as principles of “justice, equity and goods conscience”. It further stated that “this reliance on the principles of English law to supply the deficiencies of an Indian enactment is not conducive to certainty or simplicity of the law.” The Law Commission therefore suggested that instead of looking into the English Common Law in case of deficiencies, one must look towards all those common law principles that have been applied by the Indian courts for nearly a century and that these principles must be added to the Act, thereby doing away with the need to refer to the English law in the given case(s). Therefore, the Law Commission in its report made an attempt to formulate these principles of law and to incorporate the same under the Indian Contract Act, 1872.

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4 Id. at 1.
5 A.I.R. 1942 Bom. 302 (393)
6 Cited in Supra note 4 at 2.
7 Id.at 2.
The Law Commission of India also stated that the law of contract is not provided in the Indian Contract Act, 1872 alone. There are various other legislations also which deal with the other branches of law of contract. According to the Law Commission also, the legislative trend has also been in favour of enacting separate legislations on the different subject matter of Contract law viz. Sale of Goods Act, 1930; Partnership Act, 1932 etc. The Law Commission cites, the Eight Report of the Law Commission on the Sale of Goods Act, 1930 on page 4, para 12 which has suggested “that laws relating to hire-purchase should be codified in a separate enactment apart from the general law of sale of goods.”\(^8\) The Law Commission on the same corollary further suggests in its Thirteenth Report for a separate and consolidated statute on the laws relating to carriers; and that the Indian Contract Act, 1872 should be left to deal with the general principles of Contract.

The researcher is of the view that the taking up of the Indian Contact Act, 1872, by the Law Commission of India for revision was certainly a notable step, in the direction of keeping the law on contract updated with the changing times and need. To meet the aspirations of people and society, changes/additions in the Indian Contract Act, 1872 are indispensable. The Law Commission has looked into the transitional phase of the society, the modern trends in and around the globe in the Contract law, looked into conflicting judicial pronouncements, suggested formulation of English Common Law principles and their incorporation in the Act, has considered and suggested for separate Acts for some branches of the Contract law, invited suggestions from the bar and the bench. The Law Commission, according to the researcher, has tried to have a holistic view of the Indian Contract Act, 1872 and to revise it taking into consideration all the important (above mentioned) parameters.

The researcher completely agrees to the reasons of the Law Commission of India to take up the Contract Act, 1872 for revision. As a corollary to the above mentioned view of the Law Commission of India with respect to separate codes, the researcher also humbly submits that there must be a separate code on the five special Contracts which have been dealt in Part-II of the Indian Contract Act, 1872 namely, Contract of Indemnity, Contract of Guarantee, Contract of Bailment, Contract of Agency and Contract of Pledge. The researcher has restricted the research to the Law of Indemnity; Law of Guarantee and the concept of consideration in the said Contracts and is of the view that separate enactments of these two branches of Contract law is

\(^8\) Id. at 3.
the need of the hour. This step of separate and consolidated enactment is required more so because the Contract of Indemnity and Guarantee are at its infancy. As has already been said by way of Judicial Pronouncements\textsuperscript{9}, that Section 124 and 125 of the Indian Contract Act, 1872 do not lay down the whole law of indemnity. Therefore, there is a compelling need to state the Law of Indemnity and Guarantee with greater certainty and stating the rights and duties; remedies of the parties with greater precision by way of a separate and consolidated statutes. Lastly, also because the acceptability of the laws by the society is also one of fundamental block for the smooth functioning of the society.

3.2. DOCTRINE OF CONSIDERATION AND ITS ASPECTS IN THE LAW OF INDEMNITY

The Law Commission of India in its Thirteenth Report, 1958 has looked into the provisions with respect to the doctrine of consideration under the Indian Contract Act, 1872. In doing so, it has dealt with the modern attitude of the doctrine of consideration and has attended to the various opinions advanced by the eminent jurists, according to whom, the doctrine of consideration requires change. The Law Commission in its report, cites Professor Holdsworth from the History of English Law, Vol. VIII, 47, who states the doctrine “as something of an anachronism.”\textsuperscript{10} He states three reasons of his saying so, one he attributes to numerous Contracts, the enforcement of which is evaded on the grounds of lack of consideration, but the law to render justice, requires such Contracts to be enforced on the grounds of “lawful intentions of the parties”. Secondly, he attributes to doctrine of consideration which prevents the enforcement of many other Contracts, had the judicial acumen not intervened to innovate the doctrine of consideration in such a way, so as to render such Contracts as enforceable. Thirdly, he attributes to the judicial innovations, which renders the doctrine both devious and technical. Further adding to the problem,\textsuperscript{11} Prof. Holdsworth, through his advancements is of the view that the doctrine of consideration need not be discarded completely, but be relegated to a subordinate position in the law of contract, ‘all agreements in which the parties intended to affect their relations, either with consideration or put in writing and signed by all parties to an agreement must be taken as valid contracts.’ On the other hand Lord Wright, who states “that the doctrine

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9 & \textit{Supra} note 5. \\
10 & Cited in \textit{Supra} note 8 at 4. \\
11 & \textit{Ibid.}
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\end{footnotesize}
of consideration in its present form serves no practical purpose and ought to be abolished.”

Supporting the view of Lord Wright, Sir Frederick Pollock states that the application of the doctrine of consideration “has been made subtle and obscured by excessive dialectic refinement.” The Law Commission refers to English Case, Dunlop Pneumatic Tyre Co. v. Selfridge and Co., which supports the above view of nipping any growing affection towards the doctrine of consideration.

Similarly, an American Jurist, Dean Pound in his work “An introduction to the Philosophy of Law” (Revd.Edn.), 155, in which he has rendered severe criticism to the doctrine of consideration. He rests his criticism on “what is consideration”, according to him, the doctrine of consideration has been boggling the minds of all since the last four centuries, and however no one is clear as to what the doctrine of consideration is? He states that the doctrine of consideration means one thing in simple contracts, another in law of negotiable instrument, still another in the law of conveyancing and still another in cases in equity. Neither the texts nor the courts have agreed to any consistent formula of the doctrine of consideration. He was also of the view that it is the promise which should be of paramount importance in the commercial world. “A man’s word should be “as good as his bond”…..This is the expression of the moral sentiment of the civilized society.”


The Law Commission in its report has referred to various observations of the jurists of Common Law Countries, and the observations of the Judges. All of which state either of abolishing the doctrine of consideration or of relegating it to the lower position in the law of contract. Despite severe criticism of the doctrine and various suggestions to its abolition by the eminent jurists; the Law Commission of India is not of the view to suggest either the abolition of

12 Ibid.
14 Supra note 12.
15 (1915) A.C. 847 (855) H.L.,
16 Ibid.
17 Supra note 14 at 5.
18 Ibid.
the doctrine or of relegating it to a lower pedestal in the law of contract. It is of the view that in the Indian context, the doctrine has been so firmly fortified and rooted in the system that its abolition would call for completely toppling up the structure on which the entire law of contract rests. Not agreeing to the view of Prof. Holdsworth, the Law Commission of India says that it is not impregnable to say that where a promise is in writing, there is no need of a consideration. However, the Law Commission of India does agree, that the rigid adherence to the doctrine of consideration leads to anomalies, therefore, suitable changes by way of addition in clauses of Section 25, must be made in the existing law.

Agreeing to the view of Prof. Holdsworth, where promises are entered into legal effect, the legal relationships must be enforced. The Law Commission in its report is of the view that great injustice would be caused in cases where the promise(s) of the promisor leads the promisee to change his stand and the promisor knows that it will be acted upon, but such promises are rendered unenforceable for the want of consideration. The Law Commission puts forward the conflict of opinions between the various High Courts in India in this regard. The Calcutta and the Madras High Court in Kedarnath v. Gorie Muhammad19 and Perumal v. Sendanatha20 cases, respectively, held the view that such promises are enforceable in as much as the expenditure was incurred “at the desire of the promisor” and that it constitutes consideration. On the contrary, the Madras High Court in Doraswamy Iyer v. Arunachala21 case, (which was later in time) held that where the facts did not justify that the expenditure was incurred at the desire of the promisor, such promise was devoid of consideration and hence unenforceable. Several instances of such promises are also mentioned in the Law Revision Committee of England and American Restatement on Contract (Under Section - 60 in the Volume on Contracts).

The Law Commission partially agreeing to the former view put forward by the Calcutta and Madras High Court (prior in time), also states that the former view put significant stress on the expression “at the desire of the promisor”. Thus in order to resolve the conflict it suggests addition of the exception to the clauses of Section 25 of the Act, on similar lines as suggested in the Sixth Interim Report of the Law Revision Committee in England.

The following additions were suggested by the Law Commission (enforceable even devoid of consideration):

19 14 Cal. 745
20 A.I.R. 1918 Mad. 311
21 A.I.R. 1936 Mad. 135
Addition to Section 25 as clause (4) – “it is a promise, express or implied, which the promisor knew or should reasonably have known, would be relied upon by the promisee, where the promisee has altered his position to his detriment in reliance on the promise; or unless”

Addition to Section 25 as clause (5) – “it is a promise to keep a proposal open for a definite period of time or until the occurrence of a specific event; or unless”

Addition to Section 25 as clause (6) – “it is a promise to dispense with or remit the performance of a promise or to extend the time for its performance”. The Law Commission of India recommends addition of this exception to Section 25 of the Act on the lines of recommendation of the Law Revision Committee of England.

The researcher supports the view of the Law Commission of India of neither agreeing to relegate a subordinate position to the doctrine of consideration in the law of contract nor agreeing to its abolition, as suggested by various eminent jurists. The researcher is of the view that the doctrine of consideration has been deeply fortified in our system, and forms one of the essentials in the formation of the Contracts.

The researcher however, agrees to the view of the American Jurist Dean Pound (supra mentioned) to the extent when he says that the problem lies in knowing “what is consideration”. According to the researcher, this question forms one of the fundamental areas of inquiry in the law of contract. According to the researcher; Section – 2(d) of the Indian Contract Act, 1872 is procedural in nature and does not “define” the term consideration in the true sense. It only states the “sense” of the word/expression consideration. On analyzing the section 2(d) one may arrive at a conclusion, that it only states the manner/procedure in which the consideration must move from one party to another. The expression it uses for the meaning of the word consideration is “something”. The answer lies in knowing what this “something” is; it is humbly submitted that the Law Commission of India in its report has failed to look into this area of concern in section 2(d) of the Indian Contract Act, 1872. The said area of concern is duly addressed in the present thesis.

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22 Supra note 18 at 77.
23 Id. at 78.
24 Ibid.
The researcher further submits that despite an early attempt made by Lush J., in Currie and Others v. Misa case, 25 to “define” consideration, in which he said “A valuable consideration, in the sense of the law, may consist either in some right, interest, profit, or benefit accruing to the one party, or some forbearance, detriment, loss, or responsibility, given, suffered, or undertaken by the other”, neither the legislature nor the Law Commission has ever attempted to fix this grey area. This judgment came after the passing of the Indian Contract Act, 1872 on February 11, 1875. The Researcher therefore, humbly submits that an attempt be made, possibly on the lines of Currie and Others v. Misa, to “define” the expression “consideration” under 2(d) Indian Contract Act, 1872.

The researcher further agrees to the view of the Law Commission in following the view of the Prof. Holdsworth, though partially, that a promise which intends to create legal relationships must be enforced, no matter whether they are impregnated with consideration or not. To settle judicial conflicts of opinions also, the Law Commission suggested some additions of exceptions in Section – 25 (supra discussed) of the Indian Contract Act, 1872. The researcher supports the view and recommendations of the Law Commission, in which it does not recommend writing as a substitute for consideration and any alternative for consideration.

Last but not the least, the above discussed recommendations, also supported by the researcher, are still pending and as yet have not been incorporated in the law. It is therefore, humbly submitted that the recommendations of the Law Commission may please be taken up and accordingly incorporated in the Act. The researcher has also suggested a recommendation, with respect to incorporation of a precise definition of “consideration” under section 2(d) of the Indian Contact Act, 1872 on the lines of definition given by Lush J., in the case of Currie and Others v. Misa, 1875, which may also be looked into and considered for recommendation for incorporation in the Act.

It is further submitted that the future and fluctuating aspect of consideration, which forms a fundamental and innate aspect of consideration in the Special Contracts, especially Contract of Indemnity and Guarantee, has not be dealt/addressed by the Law Commission of India in its Thirteenth Report. The said concern is an area of research in the present thesis, and an endeavour

25 (1874-75) L.R. 10 Ex. 153
is made to study and look for the future and fluctuating aspect of consideration in the Contract of Indemnity (in the present chapter) and Contract of Guarantee (in the subsequent chapter). It is also fundamental to first understand and not to confuse “future” aspect of consideration with the “executory” consideration. By “future” aspect of consideration in the Contract of Indemnity or Contract of Guarantee, we refer to an ingredient of “uncertainty” both objectively (at the time of formation of Contract) and subjectively (at the time of actual execution/implementation of Contract). By “future” consideration in the Contract of Indemnity, we mean uncertainty with respect to happening of loss or not; when the liability to pay for the loss would be incurred etc. The answers to such questions are not in contemplation of the parties at the time of formation of Contract, the consideration (loss) has a future aspect at an objective stage (formation of Contract); but in case of executory consideration the aspect of uncertainty does not exist at the objective level (formation of Contract). Since the parties have with certainty contemplated the Contract at the formation level itself, it is only its actual execution (subjective aspect) which is pending and this “future” aspect of consideration in the Contract of Indemnity also has a “fluctuating” aspect in as much as there is a degree of uncertainty with respect to the actual liability to be incurred which would be dependent on a future event and not to be exclusively determined by the limit put in the Contract of Indemnity.

### 3.3 THE LAW OF INDEMNITY

According to the Law Commission of India, the law of Contract on Indemnity is not exhaustive as it fails to cover up the law exhaustively. According to the Law Commission of India, the law of Indemnity under Section – 124 of the Act deals with only “one” class of Indemnity. Similarly, Section – 125 of the Act, deals with only “some” of the rights belonging to an Indemnity-holder of that particular class. The Law Commission citing Lord Wright from the Secretary of State v. The Bank of India, A.I.R. 1938 P.C. 191 (192), since the Act is not exhaustive, the courts had to look upon “the common law of India which in this respect, is identical with the law of England.”\(^\text{26}\)

The Law of Indemnity under the Indian law is given under the Indian Contract Act, 1872; which are Sections 124 and 125 of the said Act. Section 124, reveals the Contract of Indemnity,

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\(^{26}\) Cited in *Supra* note 24 at 48.
the 13th Law Commission of India is of the view that the definition of Contract of Indemnity is narrow in comparison to the definition of the Contract of Indemnity under the English law, which is wider, as it includes “a promise to save the promisee from loss caused by events or accidents which do not or may not depend on the conduct of any person, or from liability arising from something done by the promisee at the request of the promisor. A right to Indemnity may be created by express contract or by implied contract.”

Under the English law, there is another class of cases where the law attaches a legal or equitable duty to indemnify in the particular set of circumstances. Such are those cases in which an act is done by one at the request of the other, the act in itself is not manifestly tortious to the knowledge of the person doing it but such act turns out to be injurious to the rights of the third party, the person doing it is entitled to an indemnity from the one, who requested him to do the act. This statement from Mr. Cave’s argument in Dugdale v. Lovering case was approved by Lord Halsbury, L.C. in Sheffield Corporation v. Barclay case. The Law Commission in its reports is of the view that such class of cases be classified under Quasi-Contractual head, a view also supported by Prof. Winfield. In view of the same, the Commission has recommended incorporation of a new Section – 72(A) in the Chapter of Quasi-Contracts under the Principal Act.

The Law Commission in its report is of the view that section – 125 only deals with rights of the indemnified in the event of his being sued. It says that the section does not deal with other rights of the indemnified, besides those mentioned in section –125. The Law Commission has looked into the conflict of opinions between the various High Courts with regard to the remedies available to the Indemnity-holder, whether the Indemnity-holder can compel the indemnifier to meet the liability, when the actual loss is suffered or the Indemnity-holder can compel indemnifier to meet the liability in the event when the liability to pay has become absolute? The Calcutta, Madras Allahabad and Patna High Court were of the view that Indemnity-holder can require the indemnifier to pay for the loss at the point when the liability has arisen, without

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27 Id. at 48.
28 Ibid.
29 (1875) L.R. C.P. 196
30 (1995) A.C. 392
32 Ramalinga v. Unnamalai Achi, 38 Mad. 791. Ibid.
33 Abdul Majeed v. Abdul Rashid, A.I.R. 1936 All. 598. Ibid.
34 Chuni Bai Patel v. Nathu Bai Patel, 22 Pat. 655. Ibid.
waiting for the sufferance of the actual loss or waiting until the Indemnity-holder has actually discharged it. On the contrary, the Nagpur \(^{35}\) (Judicial Commissioner), Lahore \(^{36}\), Bombay \(^{37}\) (1940) High Courts, were of the view that the question of indemnifying for the loss only arise when the loss has actually occurred and not when the liability to pay has arisen. The Law Commission of India in its report has supported the former view given by the Calcutta, Madras, Allahabad and Patna High Court. Chagla J. in Gajanan Moreshwar v. Moreshwar Medan case \(^{38}\), explained the position and since then the Bombay High Court has also followed Calcutta, Madras, Allahabad and Patna High Court. The Law Commission is of the opinion that the view of Chagla J. is correct and should be adopted in the Act.

However, the Law Commission also states that under the English Law, the Indemnity holder cannot compel the indemnifier to pay for the loss until actual loss has incurred. But in equity such action is allowed on grounds that when liability to pay has become absolute, even though no actual loss has yet resulted, the not allowing of the action would lead to great hardship and injustice. This rule has been introduced in the Courts of Equity in England to mitigate the rigour of the Common Law. This rule is based on the principle “to save [the Indemnity-holder] from loss in respect of the liability against which the Indemnity has been given”\(^{39}\) and “not merely… to reimburse in respect of money paid.”\(^{40}\) This rule is very much consistent to the view of the Calcutta, Madras, Allahabad, Patna and Bombay (1942 onwards), also accepted by the Law Commission of India.\(^{41}\)

3.4 RECOMMENDATIONS BY THE LAW COMMISSION OF INDIA ON THE LAW OF INDEMNITY

\(^{36}\) Ranganath v. Pachusao, A.I.R. 1935 Nag. 117. \(Ibid.\)
\(^{38}\) A.I.R. 1942 Bom. 302
\(^{39}\) Supra note 28 at 51.
\(^{40}\) \(Ibid.\)
\(^{41}\) The Law Commission of India has also gone through the rights and remedies of the Indemnity-holder in equity, as described by the Halsbury’s Laws of England: “……in equity, the rules of which now prevail in all Courts, even in the absence of such a special agreement, the person entitled to the Indemnity may enforce his right as soon as his liability to the third party has arisen, and, therefore, he may obtain relief before he has actually suffered loss. He may, therefore, in an appropriate case, obtain an order compelling the promisor to set aside a fund out of which the liability may be met or to pay the amount due directly to the third party, or even, when the promisor is under no liability to the third party, as is the case in Contracts of mere Indemnity, to the promisee himself. Nor is the party indemnified precluded from obtaining relief by the fact that his liability to the third party cannot be effectively enforced against him”. Cited in \(Ibid.\).
(a) EXPANSION OF SECTION – 124 – The Law Commission recommends that the definition of ‘Contract of Indemnity’ in section 124 be expanded to include cases of loss caused by events which may or may not depend upon the conduct of any person; and also to provide clearly that the promise may be implied. The 13th Report of the Law Commission of India, 1958, has recommended that S-124, Indian Contract Act, 1872 be substituted as follows (words in italics in the following definition are additions to the present definition of S-124 in force):


A Contract by which one party promises, expressly or impliedly, to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person or by any event not depending on such conduct, is called a “Contract of Indemnity.”\textsuperscript{42}

(b) INCORPORATION OF NEW SECTION – 72A IN THE ACT–The Law Commission is of the view that after section 72 of the principal Act, the following sections shall be inserted, namely:

“72A. When Contract of Indemnity may be implied.

When an act is done by one person at the request of another, and the act, not being in itself manifestly tortious to the knowledge of the person doing it, turns out to be injurious to the rights of a third party, then, in the absence of express agreement to the contrary, the person doing it is entitled to be indemnified by the person at whose request it is done”\textsuperscript{43}

This recommendation is in consonance with the view put forward by Lord Halsbury and Prof. Winfield (supra discussed).

(c) ADDITION OF SECTION 125A IN THE ACT –The Law Commission is of the view that Section – 125 of the Act only lays down “some” rights of the Indemnity holder for the given one class of cases under the Act. With a view to incorporate other necessary rights of the Indemnity holder, the Law Commission recommends addition of Section – 125A after Section – 125 of the Act. The Law Commission is of the view that section – 125 does not cover all the rights/remedies of the Indemnity holder, therefore the rights of the Indemnity-holder should be

\textsuperscript{42} Id. at 84.

\textsuperscript{43} Id. at 83.
more fully defined by way of insertion of Section – 125A in the Act. The Law Commission is also of the view that remedies of an Indemnity-holder be indicated even in cases where he has not been sued

The 13th Law Commission of India has recommended the insertion of a new section after Section 125 as Section 125 A as follows:

“125A Rights of Indemnity-holder.

(1) The promisee in a Contract of Indemnity acting within the scope of his authority may, where a liability has arisen against him in favour of a third party, obtain against the promisor, in an appropriate case, a decree compelling the promisor to set apart a fund out of which the promise may meet such liability or directing the promisor to discharge such liability himself.

(2) The promisee may institute a suit under this section even where no such suit as is referred to in section 125 has been instituted, and irrespective of whether any actual loss has been sustained by the promise or not.

Explanation - The promisee is not precluded from obtaining relief under this section merely on the ground that the promisee’s liability to the third party cannot be effectively enforced against him.”

3.5 JUDICIAL INNOVATIONS

The aspect of loss to be covered under the law of Indemnity for certain and uncertain events required lot of deliberations. Researcher analyzed the law of land (supra discussed) in this regard. The other aspects of loss (consideration) in the form of judgments are also studied for uncertain events, insurance, equitable principle, stretching of consideration, breach of contract, under motor vehicle insurance, letter of indemnity, conditional contract and implied indemnity. They are also analyzed in detail by the researcher to study the different aspects of consideration under the law of Indemnity.

3.5.1 Uncertain Events Not Endorsed Under The Law Of Indemnity for Consideration

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44 Id. at 84.
In General Assurance Society Ltd. v. Chandumull Jain and another case,\(^{45}\) the issue regarding uncertain events was discussed in detail by the Apex Court. The facts of the case raised the issues related to the uncertain events under the law of Indemnity and the position has been clarified on the basis of proximate relation between risk and the loss. Researcher made in-depth study on the following facts of the case –

The respondent Shri Chandumull Jain and Anrs made a proposal on June 02, 1950 to the Petitioners for insurance of some houses at Dullian from damage against Fire, and Floods etc. The proposal was accepted by the petitioner on June 03, 1950 and the period of insurance was from June 3, 1950 to June 2, 1951. The acceptance was by way of two letters on the back of which was the endorsement of the causes for which insurance is covered viz. floods, cyclone, change of course of river together with the description of the houses. The letters were silent about any terms of the insurance policy. However, the letter did mention that the insured was covered under two cover notes\(^{46}\) enclosed with the letter. The cheque for the premium amount was sent by the respondent on June 7, 1950 and the respondent had written to the petitioner for the delivery of the policy, but it was not done. On July 6, 1950; relying on condition 10 of the policy, the risk was cancelled on and from July 6, 1950 by the Petitioner – Insurance society. In reply the petitioner relied on Condition 10 of the Fire Policy, which read as follows:

“This insurance may be terminated at any time at the request of the Insured, in which case the Society will retain the customary short period rate for the time the policy has been in force. This insurance may also at any time be terminated at the option of the Society, on the notice to that effect being given to the insured, in which case the Society shall be liable to repay on demand a ratable proportion of the premium for the unexpired terms from the date of the cancelment.”

The respondent disagreed the cancellation, and claimed for the risk on July 15, 1950; stating that the company was bound on the ground that at the time of proposal and acceptance

\(^{45}\) AIR 1966 SC 1644.

\(^{46}\) The two cover notes stated that “The said property is hereby held insured against, damage of Fire, subject to the terms of the Applicant’s proposal and to the usual conditions of the society’s policies.” The cover note also stated, under no circumstances would it be applicable for a period exceeding 30 days. On June 07, 1950 the premium was sent through cheque by the respondent to the petitioner.
there was no erosion and now when the erosion, change of course of river has commenced, the petitioner is trying to escape from its liability. On July 17, 1950 the petitioner cancelled the policy in an endorsement w.e.f July 6, 1950.

In reply, the respondent – Chandumull Jain stated on August 02, 1950 that the condition applied only in case of fire insurance and not otherwise; it could also not protect the company once the risk has commenced. The houses were washed away on August 13th and 15th, 1950. Due to futile attempt of the respondent to get payment, the respondent filed the suit in the Calcutta High Court, single bench, which was dismissed with costs.

The cover letters which were issued to the respondent said that the insurance was subject to the ‘usual conditions of the Society’s policies.’ Relying on Condition 10 of the Fire Policy, the society cancelled the risk of covering the houses from flood. The houses were washed away and the respondent demanded payment under the policy. The matter proceeded from the single bench, High Court Calcutta to the division bench, High Court, Calcutta, where the Hon’ble Judge reversed the judgment of the single bench judge and decreed the claim of damages to the respondents. The matter then came up to the Hon’ble Supreme Court for adjudication and the following issues evolved:

1. Whether Condition 10 of the Fire Policy was applicable to the facts of the case?

2. Whether the said condition was reasonable?

3. Whether the cancellation of the policy by the society - Petitioner was valid?

Researcher, analysed the observations of Hon’ble Supreme Court\(^\text{47}\) in this case and agreed to the extent, that no matter the fire policy was not issued and delivered to the respondent, the fact that the letter of acceptance and the cover notes were issued, the Contract of insurance have come into existence and was complete. Therefore, for the same reason the rights of the parties were governed by the policy, from the date of acceptance and the terms given in the policy customarily apply. The letter of acceptance and cover notes clearly stated that the Contract of fire insurance policy extended to cover flood, cyclone etc. Since the cover notes also stated that the usual terms of the society’s policies would apply, under the said circumstances the

\(^{47}\) Supra note 45.
terms of the policy including Condition 10 of the policy would therefore apply. Hence, condition 10 which is in question formed part and parcel of the usual condition of the insurance policy, which could very well be invoked by the society. The Condition 10 of the Fire Policy gave equal rights of cancellation to both the parties therefore could not be called as unreasonable. By virtue of equal rights conferred on the parties, either party was capable of cancelling the policy. Thus, the insurance company by invoking Condition 10 of the Fire Policy could very well cancel the policy.

However, the cancellation is different from avoiding the liability i.e. Cancellation would not mean to avoid liability for loss which has taken place, or to avoid risk when it has already started turning into a loss. Cancellation is reasonably possible before the liability under the policy has commenced or has become inevitable. The question of liability is the question of fact which needs to be determined as per the facts of the case in question. In the present case, looking into the facts of the case, the Hon’ble Supreme Court observed that it could not be said that the society cancelled the policy after the commencement of the loss or when it had become inevitable. As on the date of cancellation of the fire policy, on the scrutiny of the evidence, the houses were 400/500 feet away on July 06, 1950. The loss had not commenced or it had not become so certain as to be inevitable or that the cancellation was done in anticipation and with knowledge of inevitable loss. It is crystal clear on the basis of above facts that the Hon’ble Supreme Court had observed and held that cancellation of policy by the insurance society was valid as respondent could not establish that there was a proximate relationship between the loss and risk.

Broadly, it may be said that Hon’ble Supreme Court agreed with the proximate relationship between the loss and the risk, without differentiating between insurance and Indemnity. The researcher analyzed Sections 31\(^{48}\) and 124\(^{49}\) of the Indian Contract Act, 1872\(^{50}\)

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48 Section- 31 of the Indian Contract Act, 1872 S.31 “Contingent Contract” defined - A “contingent Contract” is a Contract to do or not to do something, if some event, collateral to such Contract, does or does not happen.

49 Section- 124 of the Indian Contract Act, 1872 S.124 “Contract of Indemnity” defined - 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.

50 In “Pollock & Mulla The Indian Contract Act, 1872” 14\(^{th}\) edition, by Nilima Bhadbhade, the author on page 1336 (dealing with Contracts of Indemnity defined) while referring the present case, has stated that “It has been held that a Contract of fire insurance is a Contract of Indemnity and the insured has to prove the loss incurred, the sum mentioned being the utmost limit of insurer’s liability; and although not covered by the section, would properly come under S.31 of the Contract Act.”
and is of the view that there is a difference between two sections as the former is event based and the latter is condition based respectively. Above all, the edifice of both the provision is based upon Contract. The object of the insurance policy was to cover up the loss which may be on the basis of event or condition subject to that, there is a proximate relationship between the loss and the event. Subjectively, there is no difference between event and condition, as event is based upon the happening or non-happening of the condition. The object of Section 124 of the Indian Contract Act, 1872 is to cover up the loss and the object of Section 31 (contingent contract) is based upon happening or non-happening of the event. In the present case (supra discussed) the insured Chandumull could not establish the commencement of the loss but one thing is clear that if Chandumull could have established the commencement of the loss before the cancellation of the policy then the General Assurance society – Petitioner could not cancel the policy on the facts of the case and would have therefore, been entitled to pay for the loss to the Respondent(s) under the Contract.

3.5.2 Actual Loss Sustained Under Indemnity

The concept of loss sustained under the law of indemnity is well recognized but the concept “actual loss sustained” was not clarified under section 124\(^51\) of the Indian Contract Act, 1872. The issue of actual loss sustained came up for hearing before the Hon’ble Supreme Court in the year 1967 in V. M. R v. Mr. Ramaswami Chettiar and Anr. v. R. Muthu Krishna Iyer & Others case\(^52\) on the following facts, which are given below for academic discourse.

The property which belonged to the second defendant and his minor son (third defendant) was sold by second defendant to the vendee. The second defendant also agreed to indemnify for any loss which may come to the vendee in future, due to setting aside of the sale to the tune of the minor son’s share in property (half share), if any. The vendee sold the property to the plaintiff and the Indemnity Bond issued by the second defendant was also assigned to the plaintiffs in their favour. The plaintiffs got the possession of the property. Third defendant, after acquiring majority sued the plaintiffs for setting aside the sale in respect of his half share. The suit of setting aside the sale in respect of his half share was decreed in favour of third defendant, on the condition that he would pay a sum of Rs.7000/- to the defendant. But the plaintiffs

\(^{51}\) Supra note 49.
\(^{52}\) AIR 1967 SC 359.
continued in possession of the property. Meanwhile, the creditor of the third defendant obtained a money decree in his favour and the property of third defendant was attached and put to sale by the court. The property which was in possession of the plaintiffs continued in their possession, while the same property was purchased by the brother-in-law of the plaintiffs for Rs.736/- subject to the liability for payment of Rs.7000/-. The plaintiffs filed a suit for the recovery of half the consideration, on the ground of loss of one-half of the property and recovery of damages from the second defendant. The trial court decreed the suit. The matter went to the High Court, it reduced the amount to the extent of actual loss sustained by the plaintiffs. On the basis of the facts and circumstances of the case, Hon’ble Supreme Court upheld the decision of the High Court and dismissed the appeal.

Researcher analysed the procedural and substantive law in this regard; the Hon’ble Supreme Court observed that the trial court was right in stating that the court sale in favour of the brother-in-law of the plaintiff was a benamidar transaction and the plaintiff did not lose possession of the property. But the Hon’ble Supreme Court did not agree to the trial court in granting the decree in favor of the plaintiff in as much as the plaintiffs asked for half the sum of consideration minus Rs. 7000/- plus a sum of Rs.500/- as court expenses. The trial court took the view that since the transaction was benami, it was the plaintiffs who had purchased the third defendant’s half share in the court sale, and it could be assumed that the third party has purchased the same as plaintiffs were not bound to purchase the same. The matter was deliberated in the High Court of Madras, which stated that “loss” under the Contract of Indemnity in the given case related to the “actual loss sustained”, which in the given case was Rs.736/- paid in the court sale and Rs.500/- spend as court expenses in defence proceedings against the third defendant, and 6% p.a. interest from the date of the suit.

The Hon’ble Supreme Court did not agree to the contention of the plaintiffs (appellants) that court sale was a benamidar and an independent transaction and the “loss” to the plaintiff accrued from the date of the order passed for setting aside the sale for half the share of third defendant, the plaintiffs lost title to half the share of the property and were therefore entitled to get back half the amount of consideration under the Indemnity Bond. According to the Indemnity Bond, defendant 2 was entitled to pay for the loss only “in case the sale of the share of the said minor son Chidambaram is set aside and you are made to sustain any loss.” The Hon’ble
Supreme Court deliberated on determining the meaning of “sustain any loss.” Clubbing the understanding that the sale of half of the share of defendant 3 (minor son) was voidable (if the defendant chose to avoid it) neither it was void-ab-initio nor it was for any legal necessity. Under such circumstances, the Indemnity Bond becomes enforceable only if the buyer was dispossessed from the properties in dispute. The Hon’ble Supreme Court held that “A breach of the covenant can only occur on the disturbance of the vendee’s possession and so long as the vendee remains in possession he suffers no loss and no suit can be brought for damages either on the basis of the Indemnity Bond or for the breach of a covenant of warranty of title.” In the present case, it was found by the High Court that the brother in law was the one who was managing the estate of the plaintiffs and he was the one who was defending the case, for setting aside the sale of half share of the minor son of defendant, on behalf of the plaintiffs. And at no point of time the plaintiffs were dispossessed of the land. Under such circumstances, agreeing to the decision of the High Court in granting a sum of Rs.1236/-, the Hon’ble Supreme Court held that the “actual loss sustained” was to the tune of Rs. 1263/- and the High Court of Madras was right in granting such amount. The Appeal by the plaintiffs was dismissed.

In accordance with the definition of the Contract of Indemnity, as provided under Section-124 of the Indian Contract Act,1872 the loss in question must be “caused either by the promisor himself or by the conduct of any person”. In the present case, the loss caused was due to human agency and not due to non-human agency. Thus, it was not required by the court to go into the question of covering Contract for “covering loss caused by non-human agency” to bring within the ambit of Contract of Indemnity by way of implication. The issue related to the “loss” is covered under Contract of Indemnity and in the present case the “Covering of loss” was in question. On analysis, one may say that the Contract of Indemnity rests on principle of assurance that the indemnifier would cover up the loss of the party who sustained loss/actual loss. This case is important as it relates to one of the basic contentions of the researcher that the Contract of Indemnity though certain, is uncertain with respect to the when and how much the indemnifier is entitled to pay to the indemnified-party. The Contract of Indemnity is impregnated with the

54 The Supreme Court also relied its decision on cases of Privy Council, Hanuman Kamat v. Hanuman Mandur (1892) I.L.R. 19 Cal. 123 (P.C.) and Bassu Kaur v. Dhum Singh (1889) I.L.R. 11 All. 47 (P.C.), for the above position.
“future and fluctuating aspect of consideration” that there is no certainty about the interest in consideration, whether indemnifier has to pay or not? In case yes, then it is to be seen, when the indemnifier has to indemnify another party. Sections 124 and 125 of the Indian Contract Act, 1872 are silent in this regard; the covering of loss at first instance or second instance, as a matter of practice has been filled up with the help of customs/ practices opted by the parties. Legally and commercially, the Contract of Indemnity forms one of the most important ingredients of any contact today. The implications of law of indemnity are not certain, they may be towards actual loss sustained by the parties or sometimes the parties work to bind the parties for commercial interests, as it forms an “attractive” clause of any Contract.

In view of the above deliberations, researcher is of the firm view that where loss has to be assessed, there is a requirement of actual loss to be determined instead of objective loss suffered by the parties. The decision of Hon’ble Supreme Court gave us a kind of pavement as well as edifice for the invoking of provisions i.e. Section 124 of the Indian Contract Act, 1872. Every time customs and practices are not going to fill up the gaps of the transactions so this decision may be helpful for the litigants to assure actual loss.

3.5.3 Principle of Subrogation evolved as Remedy to cover up the loss

In Lala Shanti Swarup v. Munshi Singh & Ors. case\(^55\), court has discussed the implications of implied indemnity; which resulted into principle of subrogation evolved as a remedy. The researcher would focus on the law of indemnity in the said case; the respondents had executed a simple mortgage on 09.05.1914. Sometime later they sold half of the said property with encumbrance, to the appellants vide sale deed dated 09.02.1920. The appellants were given the possession of the property and out of the total consideration settled (Rs.16000) for the property, the amount (Rs.13500) which the appellant was entitled to give mortgagor (principal and interest) was left with the appellants for payment to the mortgagor. However, the money was not paid to the mortgagor. The mortgagor, thence brought a suit against the

\(^{55}\) AIR 1967 SC 1315; For details on Right of Subrogation in the Contract of Indemnity, refer to Landmark Judgment of Constitutional Bench of the Hon’ble Supreme Court in the case Economic Transport Organisation v. M/s Charan Spinning Mills (P) Ltd. &Anr. (2010) 4 SCC 114. This landmark case, expressly provides for the right of subrogation in the Contract of Indemnity as innate and inherent; impressively explains the Concept of Subrogation; Difference between express subrogation and implied subrogation; Meaning of Assignment; Difference between Subrogation and Assignment; Categorization of Subrogation – Subrogation by equitable agreement; Subrogation by Contract; Subrogation cum Assignment; Principle of Subrogation.
respondents for the recovery of the mortgage amount. On 04.02.1937, decree was granted against
the respondents for about Rs.26000/-. The respondents then applied under the U.P. Encumbered
Estates Act, for the apportionment of the liability between the appellants and respondents. The
liability was accordingly apportioned by order dated 22.05.1939 between the respondents and
appellants, as the appellants were owners of half of the mortgaged property. Each were held
liable to pay Rs.14,307/9/6. In the order the respondents were also made liable to pay interest of
6% p.a. from 01.08.1993 till 28.09.1936 and thereafter 41% p.a. Subsequently, the Collector
under the U.P. Encumbered Estates Act, took the proceedings for the liquidation of the debt and
“directed the respondents to execute a self-liquidating mortgage of three-fourths of their half-
share” for a sum of Rs.20,800/-. The mortgage was executed on 25.02.1943. Because of the
execution, the respondents had to deliver three-fourth share of their property to the mortgagees.
Post this, the respondents brought a suit against the appellants for the recovery of Rs.18000/- and
interest as “loss” incurred/ sustained by them due to failure of the appellants to discharge/ pay
the original mortgage of 1914. The suit was instituted on 30.07.1943.

The contention of the appellants (defendants) at the trial court was that the suit for
compensation for the breach of Contract should be instituted within six years from the date on
which the breach of Contract has been committed and in the present case it took place in the year
1920 when the appellants were unable to pay to the mortgagee the amount within a reasonable
time. But the contention was not accepted by the trial court and the trial court decreed the suit in
favour of the plaintiffs. The matter came in appeal to the High Court, division bench, which was
referred to the Full Bench of five judges which held that the time would begin to run from
25.02.1943 and Art. 83 read with 116 of the Limitation Act, 1908 would be applicable in the
present case. The division bench on receipt of the decision of the Full Bench dismissed the
appeal and affirmed the judgment of the trial court. The matter came up to the Hon’ble Supreme
Court to deliberate on the issues of limitation and implied indemnity.

The contention of the Appellants that Article 83 will not be applicable in the present case
and that Article 116 would be applicable, further the time began to run when the covenant to pay
off the encumbrance was broken was not accepted by the Hon’ble Supreme Court. In deciding
the above matter, the Hon’ble Supreme Court stated that in cases where the property with
encumbrance is sold to the purchaser with the condition that the purchaser will pay off an
encumbrance, it gives rise to two different causes of actions. One arises when the purchaser fails
to discharge his liability under the covenant to pay the mortgagee, it entitles the vendor to bring
an action to have himself put in a position to meet the liability which the purchaser has failed to
meet. Another arises by virtue of “implied Contract of Indemnity” between the seller and the
purchaser, which entitles the vendor to bring a suit against the purchaser for covering up the loss
which the vendor has incurred due to failure of the purchaser to pay the sum. The contention of
the appellant that there was no Contract of Indemnity was rejected by the court, it said that the
Contract of Indemnity was implicit, in as long as the purchaser under the covenant was to meet
the previous encumbrance on the property sold. It was an “implied Contract of Indemnity”
between the seller and the purchaser. Stating so, the Hon’ble Supreme Court said that Article- 83
of the Limitation Act, 1908 has application in the present case which applies to both express and
implied Contract of Indemnity, under which the suit is to be brought within six years (as the sale
deed is registered) from the time when the plaintiff was actually damnified. In arriving at this
decision, the Hon’ble Supreme Court referred and relied on the observation by the Judicial
Committee in Musammat Izzat-un-Nissa Begam v. Kunwar Pertab Singh56

The contention of the appellants that even if there was a Contract of Indemnity in the
given case, the cause of action arose on 04.02.1937 (when the final mortgage decree was passed)
and not on 25.02.1943 (when the respondents/ plaintiffs were dispossessed), was also rejected by
the Hon’ble Supreme Court. The Hon’ble Supreme Court held that in given case, the purchaser
was under the covenant “to relieve the vendor from the liability of the mortgages” and in as
much as there existed a Contract of Indemnity, in favour of the vendor, the statute of limitation

56 36 I.A.203. At page 208 of the Report the Judicial Committee clearly expressed the proposition as follows : "it seems to depend on a very simple rule. On the sale of property subject to encumbrances the vendor gets the price of his interest, whatever it may be, whether the price be settled by private bargain or determined by public competition, together with an Indemnity against the encumbrances affecting the land. The Contract of Indemnity may be express or implied. If the purchaser covenants with the vendor to pay the encumbrances, it is still nothing more than a Contract of Indemnity. The purchaser takes the property subject to the burthen attached to it. If the encumbrances turn out to the invalid, the vendor has nothing to complain of. He has got what he bargained for. His Indemnity is complete. He cannot pick up the burthen of which the land is relieved and seize it as his own property. The notion that after the completion of the purchase the purchaser is in some way a trustee for the vendor of the amount by which the existence, or supposed existence, of encumbrances has led to a diminution of the price, and liable, therefore, to account to the vendor for anything that remains of that amount after the encumbrances are satisfied or disposed of, is without foundation. After the purchase is completed, the vendor has no claim to participate in any benefit which the purchaser may derive from his purchase. It would be pedantry to refer at length to authorities.” This decision was followed by the Full Bench of the Allahabad High Court in Tilak Ram v. Surat Singh, I.L.R. [1938] All. 500.
would begin to run not on the date when mortgage deed was obtained against the plaintiffs/respondents but when the actual loss was sustained i.e. on actual damnification. Therefore the period in the present case begins to run on 25.02.1943\textsuperscript{57}, when the seller was actually damnedified.\textsuperscript{58} Hence, the suit was in time. The appeal was actually dismissed.

The researcher would not go into the limitation aspect of the case and would restrict the analysis to the “implied Contract of Indemnity” in the given case. According to the researcher, the Hon’ble Supreme Court was right in stating that there existed an implied Contract of Indemnity between the seller and the purchaser, when the property with encumbrances was sold to the purchaser with the covenant that the buyer would pay the mortgagee the sum and would relieve the vendor from the liability of mortgage. According to the researcher, there exists an implied Contract of Indemnity in the given case on the basis of facts and circumstances; which allows the seller to bring a suit against the purchaser for covering up the loss which the vendor-seller has incurred due to failure of the purchaser to pay the sum. The purchaser in the given case is the indemnifier and the seller has to be indemnified; where the purchaser promises to save the seller from the loss caused to him by the conduct of the promisor (purchaser).

\section*{3.5.4 Contract of Indemnity Invoked and Equitable Principles followed}

In United Commercial Bank Ltd. v. Okara Grain Buyers Syndicate Ltd. & Anr case,\textsuperscript{59} equitable principle was invoked to indemnify the Okara Grains Buyers Syndicate (hereinafter referred to as syndicate/respondent) was registered under the Indian Companies Act, 1913, having its registered office at Okara, District Montgomery (in undivided Punjab).

\textsuperscript{57} Article 83 of the Limitation Act applies to this case, and as the sale deed is a registered document the plaintiff has six years for bringing the suit from the time when he is damnedified or actually suffers loss. Kumar Nath Bhutacharjee v. Nobo Kumar Bhutacharjee, I.L.R. 26 Cal, 241; RatanBai v. Ghasiram Gangabisan Wani, I.L.R. 55 Bom, 565; Harakchand Tarachand v. Sumatilal Chunilal, 33 Bom, L.R. 1200; GulabraoVithoba v. Shamrao Jagoba, A.I.R. 1948 Nag. 401; Naima Khatun v. Sardar Basant Singh, I.L.R. 56 All. 766; Ram Barai Singh v. Sheodeni Singh, 16 C.W.N. 1040 and Venkatanarayaniah v. Subramania Iyer, 74 Indian Cases 209 decisions referred and relied.

\textsuperscript{58} In the words of the Hon’ble Supreme Court, “The mere fact that a mortgage decree has been obtained against the plaintiff is not sufficient to put the statute in motion. In other words, the statute runs not when the event happens which caused the loss but on the actual damnification.”

"Where the covenant is to indemnify or save harmless, no action can be brought till some loss has arisen; so it is also where the covenant is to acquit from damage by reasons of a bond or some particular thing; and in either case the proper plea is non damnificatus.” (1 Wms. Saund. 117, n. 1). In Collinge v. Heywood (1839), 9 A. & E.B. 633, referred and relied.

\textsuperscript{59} AIR 1968 SC 1115
The Government of undivided Punjab devised a scheme in 1946 for the procurement of food grains, the Government appointed the syndicate to procure food grains on its behalf. As per the conditions of the scheme, syndicate was required to make some deposits with the recognized bank. In pursuance of the conditions, the syndicate made a deposit of Rs.40000/- with the United Commercial Bank (hereinafter referred to as the bank) and obtained a fixed deposit receipt from the bank.

As per the terms of the receipt, the deposit of Rs.40000/- at 2% per annum was to remain till notice of twelve month for its withdrawal by either side expires. Accordingly, the syndicate served a notice of withdrawal on 29.03.1947 upon the bank and an endorsement in that behalf was made on the receipt. The receipt was then handed over to the District Magistrate, Montgomery. In August, 1947 communal riots broke and the non-Muslims staff and Managing Director of the Syndicate leaving all property and goods at Okaro, migrated to India and started their business by setting a new place of business at Amritsar, Punjab and got itself registered at the State of Punjab. The syndicate demanded the refund of the deposited money together with the interest from the United Commercial Bank Ltd on 26.10.1951. The bank in its reply stated that “the amount deposited will not be returned until the Syndicate obtains a discharge from the District Magistrate, Montgomery, of his lien on the fixed deposit receipt and an intimation in that behalf was given by the District Magistrate relinquishing his lien’ on the fixed deposit receipt.”

The Syndicate then filed a petition against the bank, before the Debt Adjustment Tribunal under section 13 of the Displaced Person (Debt Adjustment) Act (70 of 1951) for the payment of Rs.40000/- as principal and Rs.3200/- as interest (2% p.a. up to 03.03 1952) and future rate of 6% p.a. till date of realization. The District Magistrate (Montgomery) was also impleaded as respondent in this petition. The petition was dismissed by the trial court on the ground that the amount of Rs.40000/- deposited by the syndicate to the bank has been forfeited by the order of the District Magistrate, Montgomery and thus the petition is not maintainable. An appeal was made in the High Court of Punjab, which allowed the appeal subject to the condition that “the respondent shall give an Indemnity for restitution of the amount in the event of the Bank having to pay the amount to the District Magistrate, Montgomery.”

The Bank filed an appeal in the Hon’ble Supreme Court and some legal issues evolved for deliberation. The researcher analyzed the facts and the issues in the light of equitable
principles and law of land in this regard. The counsel of the Bank contended that the bank was under no obligation to make the payment to the syndicate unless the District Magistrate, Montgomery discharged the receipt and handed it over to the Bank acknowledging that he had no claim against the syndicate. On hearing the contention of the Bank’s counsel, the court observed that the receipt created no Contractual obligation in favour of the District Magistrate, Montgomery; nor was the bank a trustee for that officer. No bank account was opened in the name of the District Magistrate, neither was the receipt transferred to the District Magistrate as the receipt was non-transferable as per term 1 of the receipt. Relying on term 5 of the receipt, the court said that as per the condition the “deposit receipt shall be discharged by the depositors”. Mere mention of the name of the District Magistrate on the receipt or mere delivery of the receipt to the District Magistrate did not make the District Magistrate the owner of the funds deposited by the Syndicate into the bank. As per the books of account of the bank also, the funds stood to the credit of the syndicate. Therefore, it was syndicate who was the owner of the deposit and it was the syndicate alone who was entitled to ask for the payment of the deposited sum after the expiry of the notice period. The bank, therefore, in absence of any Contractual or fiduciary relationship with the District Magistrate could not withhold the money deposited into the bank from payment to the syndicate after the expiry of the notice period.

The Hon’ble Supreme Court agreeing to the decision of the High Court of Punjab said that the High court was right “in exercise of its equitable jurisdiction to direct that the money be paid to the Syndicate without production of the receipt”, since it was problematic to bring it on evidence whether the District Magistrate had the receipt or not, it was therefore reasonably inferred that the receipt was lost or destroyed. The Court further said that the High Court was right in protecting the Bank “against any possible loss by directing that an Indemnity be given by the Syndicate to the Bank for restitution if the bank is to pay the amount to the District Magistrate, Montgomery”

Another document which was forwarded by the bank’s counsel, in support of his argument of forfeiture of the amount by the Pakistan Government, was a copy of the letter.60

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60 Relevant excerpt of the letter, “he [N. A. Haroon] was directed to enclose a list of securities of non-muslims deposited with the Branch Office and forfeited at Lyallpur, Okara and the Bank was requested to make arrangements for early realization of the amount for payment to the District Food Controllers concerned.”
presented by Shamin Yazdani, dated 04.03.1949 from N A. Haroon, Officer on Special Duty, West Pakistan Government, Finance Department, Lahore addressed to the Manager, United Commercial Bank Ltd. The Hon’ble Supreme Court stated that neither the original letter nor the authenticated copy of the same was produced in the court. On scrutiny of the copy of the letter it came to light that there was “no reference to the source of authority of the officer who purported to forfeit the amount.” the letter also did not “recite that the order of forfeiture was made by him acting on behalf of the Government of Pakistan.” According to the Hon’ble Supreme Court, the amount/money was not deposited by the bank to the Government of Pakistan till the appeal was decided by the High Court. It was argued by the counsel of the bank that the bank held the money on behalf of the Government of Pakistan. The Hon’ble Supreme Court said that this argument can only be entertained provided the order of forfeiture of the money was made by the Government of Pakistan, in the present case the Hon’ble Supreme Court was of the view that due to absence of any evidence to that effect, it cannot be held that any such order was passed by the Government of Pakistan; Court further said, that it did not feel called upon to consider, whether the order of forfeiture passed by the Government of Pakistan is recognized in the Courts in India as completed discharge to their obligation to repay the sum?

The counsel of the Bank relied on the judgment of this court.61 The Hon’ble Supreme Court said that even if we assume that the law of Pakistan was applicable for the repayment of the debt, the bank has failed to prove that they were not liable to pay the money under the deposit receipt, the notice of withdrawal was also made at the time of the deposit. Looking in the facts and circumstances of the case, and after hearing the contentions of the counsel(s), the Hon’ble Supreme Court was of the view that the High Court was right in granting the appeal in favour of the syndicate and invoking the Contract of Indemnity and Hon’ble Supreme Court also stated that imposing of interest from the date of petition vested in the discretion of the High Court and it had awarded it at a rate of 6% per annum as claimed. Therefore, the Hon’ble Supreme Court did not interfere in the awarding of the interest by the High Court and the appeal was accordingly dismissed by the Hon’ble Supreme Court.

The area of interest for the researcher in this case was the invoking of the Contract of Indemnity between the Respondents/Syndicate and Bank by the High Court. The sum that was

deposited to the Bank by the Syndicate was like a debt to the bank and the bank was in the capacity of the debtor. According to the terms of the receipt, twelve months’ notice for the withdrawal, from either side was necessary; this notice was already given by the Syndicate at the time of the deposit to the Bank, and was duly endorsed on the receipt. Another condition which was relevant was that “on due date this deposit receipt should be discharged by the depositors”. The court clarified in this matter that the deposit receipt was handed over to the District Magistrate and the Syndicate was not in possession of the receipt. There was also nothing on record to prove that the District Magistrate was still in possession of the receipt, the court further clarified that in law the District Magistrate was not the owner of the money. Only because his name was mentioned on the receipt, he did not become the owner of the money. The Money was deposited by the Syndicate and the books of account of bank showed the money to the credit of the Syndicate; neither the account was opened in the name of the District Magistrate nor was the receipt transferred to the District Magistrate, as the receipt was not transferable under the terms of the receipt. Under such circumstances, there neither existed any Contractual nor any fiduciary relationship between the bank and the District Magistrate. The High Court was right in invoking its “equitable jurisdiction” and ordering for the repayment of the sum deposited in the bank by the syndicate, to the syndicate by the bank. The Court further said that since there is nothing and no record to prove that the District Magistrate had the receipt, it could be reasonably inferred that the receipt is either lost or destroyed. The terms and conditions were silent regarding the repayment of the money in case the receipt was lost or destroyed. Under such circumstances, the court by judicial innovation invoked its “equitable jurisdiction” and granted the repayment of loan together with interest. Another area where the judiciary tried to settle the matter was by way of judicial innovation, whereby the court invoked the Contract of Indemnity to be made between the syndicate and bank, if in future, the District Magistrate claims for the repayment of the loan on the basis of the receipt. Under such circumstances the syndicate under the Contract of Indemnity, must promise to indemnify the bank for any loss which is caused/sustained to the bank. According to the researcher Contract of Indemnity was invoked as remedy on equitable principles of the court in this case.

3.5.5 Consideration stretched for Contract of Indemnity and Guarantee
In Punjab National Bank Ltd. v. Bikram Cotton Mills & Anr. case, aspects of consideration were discussed on the peculiar facts and circumstances of the case. A Cash-Credit bank account was opened by the Respondent (Bikram Cotton Mills & Anr.) hereinafter referred to as the Company, with the Petitioner Bank (Punjab National Bank), hereinafter referred to as the Bank.

On 07.06.1953, three documents viz. a promissory note for Rs.13,00,000/-, a deed of hypothecation and a letter assuring the bank that the company would remain solely responsible for all loss, damage or deterioration of the stocks hypothecated with the bank, were executed by the Managing Agents of the Company on behalf of the Company, in favour of the Bank to secure repayment of the balance due at the foot the account. The Bank insisted for a promise by some other person also to pay for the debt, as a part of the same transaction. As a result one Ranjit Singh, Director of the Managing Agents of ShriVikram Cotton Mills Ltd., executed a bond called “agreement of Guarantee” in favour of the bank, agreeing to “pay on demand” all the money which may be due to the bank from the company. According to clause 4 of the bond, The Guarantee shall apply to and secure “ultimate balance” which shall remain due to the bank on such cash-credit account up to the extent of Rs.1300000/-. According to clause 1 of the bond, Mr. Ranjit Singh, Guaranteed to the bank, in his personal capacity, for the payment on demand, of all the money which may at “any time” be due to the bank by the company on the general balance of that account with the bank. According to clause 8 of the bond, the bank was (shall) entitled to recover its entire dues under the said cash-credit account from Mr. Ranjit Singh upon “default” in payment by the said borrower (company).

The company closed its business in December 1953. The stocks which were pledged with the bank were disposed by the bank and the amount received was credited to the account of the company. A balance of approximately Rs.2.56 lakhs remained due at the foot of the account. In the meanwhile, the creditors of the company filed for an order of winding up of the company in the High Court of Allahabad. A scheme of composition was also settled on 22.02.1956 amongst the creditors as per section S-391 of the Companies Act, 1956. The scheme of composition as per S-392(1) of the Companies Act, 1956, was sanctioned by the High Court on 21.05.1956, after rejecting the opposition by the Bank.

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62 AIR 1970 SC 1973
After the scheme of composition was sanctioned by the High Court, Allahabad, rejecting the opposition by the bank, the bank filed a suit in the trial court, Civil Judge, Malihabad, Lucknow, against the company and Ranjit Singh for a declaration that on the date of the suit a sum of Rs. 2,56,877-12-6 was due against the Company and for a decree for payment of that amount against Ranjit Singh with costs and interest pendent-lite. On the basis of the joint written statement filed by the company and the Ranjit Singh, the contention raised was that Ranjit Singh was “only a guarantor and not a co-debtor” and he could be only made liable in case of default by the company, since no default was made by the company, the suit against Ranjit Singh was not maintainable. The Trial Court held that no suit is maintainable against the company without obtaining leave of the Company Judge. It further held that since the composition was sanctioned by the High Court, it was the Boards of Trustees under the scheme who were to scrutinize the claim and their decision in this regard would be final. The trial court further held that the suit against Ranjit Singh was premature and he was liable only in case of default by the company. Since no default was made by the company, Ranjit Singh was not liable. Accordingly, the suit was dismissed by the trial court.

After the dismissal of the suit in the trial court, two appeals were preferred to the High Court of Allahabad. The High Court held that the composition between the company and the creditors was sanctioned by the Court, it had statutory operation, was therefore binding on all creditors irrespective of the fact, whether the creditors agreed to it or not. Bank was an unsecured debtor now, the amount payable to the unsecured creditor could only be determined by the Board of Trustees, under clause 12 of the scheme. Under clause 16 of the scheme the creditor could file a suit for establishing his claim in the court, but it had to be with the leave of the court. Since the leave of the court was not taken in the present case, therefore the suit against the company was not maintainable. The High Court further held that the bond executed by Ranjit Singh, called “agreement of Guarantee”63 was actually the “Contract of Indemnity”64 under section- 124 of the Indian Contract Act, 1872. The suit against Ranjit Singh was therefore, maintainable once “ultimate liability” of the company was determined by the Board of trustees and not before. The

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63 Section 126, Indian Contract Act, 1872, S.126 "Contract of Guarantee", "surety", "principal debtor" and "creditor" - 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.

64 Supra note 51.
High Court confirmed the decree of the trial court, even held in favour of Ranjit Singh, that the suit was premature. The matter came up to the Hon’ble Supreme Court, from the Bank by way of a Special leave to the order of the Allahabad High Court, Lucknow with some legal issues.

The Bank had only claimed for the declaration of the amount payable by the Company to the Bank. The Bank had not asked for the payment of the money from the company. It had asked Ranjit Singh to pay for the money due, as per the bond executed by him in favour of the Bank. According to the Hon’ble Supreme Court, the suit against the company was not maintainable as it failed to adhere to the provision of clause 16 of the scheme, whereby a creditor may file suit in the court of law for establishing their claims, but it has to be done with the leave of the court. In the present case since the leave of the court was not taken, therefore the suit was not maintainable.

With respect to the question of maintainability of the suit against Ranjit Singh, the High Court held that the suit was premature. According to the High Court, the bond executed by Ranjit Singh which was named as “agreement of Guarantee” was actually a Contract of Indemnity and the claim for money from Ranjit Singh did not arise till the time the amount was determined by the Board of Trustees. Until this time the Contract of Indemnity, could not be enforced against Ranjit Singh and the suit against Ranjit Singh was premature. However, the Hon’ble Supreme Court while differentiating between the Contract of Indemnity and Contract of Guarantee stated that the bond was in the nature of the Contract of Guarantee in as much there were three parties involved the company, the bank and Ranjit Singh. The Contract of Guarantee could be oral, written or partly oral or written. In the present situation, the nature of the Contract of Guarantee was such that it was partly oral and partly written. In order to support its stand of Contract of Guarantee, the Hon’ble Supreme Court looked into section 128 of the Indian Contract Act, 1872 which states that the liability of the surety is co-extensive with that of the principal debtor. The Hon’ble Supreme Court went on to analyzing the bond and its clauses, and looking for anything which would show that the liability of the surety was not co-extensive with that of the principal debtor. There was nothing in the bond which stated that the liability of the surety was not co-extensive with the principal debtor. According to the bond, the liability of Ranjit Singh was
stipulated under clause 465 of the bond to the “ultimate balance”. According to clause 1 of the bond, the demand of the money could be made by the Bank from Ranjit Singh at any time. The Hon’ble Supreme Court basing its decision on clause 166 of the bond, stated that it was not premature. The Hon’ble Supreme Court, further relied on Halsbury’s Laws of England67, Vol. 6, 3rd edn., and English case68 and held that High Court should have stayed the suit and after the “ultimate balance” due by the Company was determined by the court, it should have proceeded to decree the claim, as per clause 4 of the bond. The Hon’ble Supreme Court accordingly modified the decree passed the Trial Court, and declared that the rights of the Bank were governed according to the scheme which was sanctioned by the High Court. The Hon’ble Supreme Court further said that once the amount payable “ultimate balance” is determined, the court can proceed to decree in favour of the Bank. The Hon’ble Supreme Court set aside the decree passed by the High Court and remanded the suit to the Trial Court to be disposed off in the light of the observations made by the Hon’ble Supreme Court.

According to the researcher, the area of interest in this case is the difference between the Contract of Indemnity and the Contract of Guarantee given under sections 124 and 126 of the Indian Contract Act, 1872 respectively. The researcher is of the view that the lower courts and the Hon’ble Supreme Court were right in saying that the suit for determination of claim of the bank, against the company was not maintainable unless otherwise with the leave of the court (company judge). Since the Company was registered under the Companies Act, 1956 it could very well opt for the scheme of compromise under the provisions of the Act. More so because the company had closed its business and it was right on the part of the creditors to apply for the

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65 Clause (4) of the Bond, "(4) I further declare that all dividends, compositions, payments received by you from the said borrower or any other person or persons liable or his or their representatives shall be taken and applied as payment in gross without any right on the part of myself or my representative to stand in your place in respect of or to claim the benefit of any such dividends, compositions or payments, until full amount of all your claims against the said borrower or his/their representatives which are covered by this, Guarantee shall have been paid and that this Guarantee shall apply to and secure ultimate balance which shall remain due to you on such cash-credit account upto the extent of Rs. 13,00,000.”

66 Clause (1) of the Bond, "(1) In consideration of your Bank at my request allowing an accommodation by way of cash credit and D/D limits to M/s. S.V. Cotton Mills Ltd., at Lucknow Branch, I, in my personal capacity hereby Guarantee to you the payment on demand of all monies which may at any time be due to you from M/s. S.V. Cotton Mills Ltd., on the general balance of that account with your Bank.”

67 As observed in Halsbury’s. Laws of England, Vol. 6, 3rd edn., Art. 1555 at p. 771: “A scheme need not expressly reserve the rights of any creditors against sureties for debts; of the company, as such rights are unaffected by a scheme”.

68 It was held in Re. Garner’s Motors Ltd., [1937] Ch. 594, that the scheme when sanctioned by the Court has a statutory operation and the scheme does not release other persons not parties to the scheme from their obligations."
order of winding up of the company. The scheme was also chalked out following the prerequisites under the Companies Act, 1956. Therefore, it was statutorily and legally valid. According to clause 16 of the scheme, the suit could be filed only with the leave of the court. Therefore, it was correct to say that the suit against company was not maintainable, without the leave of the court. The researcher further states, that the bank was right in maintaining the suit against Ranjit Singh for payment of the due money, without the leave of the court. Because as per clause 16 of the scheme, leave of the court was required in suits which were instituted to determine the amount remained payable to the Bank. The leave was not required in enforcing a Contract of Guarantee against the surety.

According to the researcher, the essentials of the Contract of Guarantee require three parties and three Contracts. Under the said case, the bond was given by Ranjit Singh in favour of the bank as a part of the same transaction under which other documents were executed by the managing agents on behalf of the company in favour of the Bank. The Contract of Guarantee could very well be partly written and partly oral, in as much as it did not expressly mention that the bank was the creditor and that Ranjit Singh was the surety, which could very well be inferred from the circumstances of the case. Relying clause 1 of the bond, the Supreme Court arrived at a conclusion that since the surety was entitled to pay on demand at any time, the suit against the surety was not premature. Though clause 8\(^\text{69}\) of the bond clearly mentioned, Ranjit Singh’s entitlement of payment to the Bank in case of default by the company. Agreeing to the decision of the Supreme Court, the researcher is also of the view that the suit against Ranjit Singh was not premature even when the company had not defaulted in the payment. In arriving at an answer to the question of the point of time when the suit against Ranjit Singh could be brought, determination of whether the bond so executed by Ranjit Singh was the Contract of Indemnity or Contract of Guarantee was indispensable. The Hon’ble Supreme Court was right in saying that the bond was Contract of Guarantee and not a Contract of Indemnity. It was also right in stating that the suit against Ranjit Singh was not premature. According to the Contract of Guarantee under section- 126 of the Indian Contract Act, 1872, the liability of the surety arises on default of the principal debtor. In the present case there was no default by the company in payment, despite no default, the invoking of the Contract of Guarantee was held to be valid, on grounds of

\(^{69}\) Clause (8) of the bond, "(8) I also agree that the Bank shall be entitled to recover its entire dues under the said cash-credit account from my person or property upon default in payment by the said borrower".
“payable on demand.” To that extent this case expressly provides for the manifestation of the Contract of Guarantee with respect to “payable on demand”, irrespective of any default by the party in payment. It clearly provides that “default in payment” is not a pre-requisite in the formation and/or invoking of the Contract of Guarantee under the Indian Contract Act, 1872. A mere element of “payable on demand” is sufficient in the Contract of Guarantee. This being the case, this aspect must be expressly provided for under section 126 of the Act. The Hon’ble Supreme Court was also right in remanding the case to the trial court for the determination of the ultimate balance. The Bank, according to the researcher, could claim from the Company as well as Ranjit Singh under the Promissory note and the bond. The Bank in the present case proceeded against Ranjit Singh on the basis of the bond executed by him in favour of the bank. The bank did not proceed against the Company on the basis of the promissory note. According to the researcher the bank was free to opt for either claiming the due money through Ranjit Singh on the basis of the bond executed or claiming it through Company on the basis of the promissory note. There is nothing in the Act, which deters the right of the creditor to proceed against either the principal debtor and/or surety. Explanation to this effect may be provided in the Act under the law of Guarantee. The consideration in the bond (Contract of Guarantee) executed by Ranjit Singh as surety in favour of the bank under section- 127 of the Indian Contract Act, 1872 was the benefit.

3.5.6  Promise to Save Another from the Breach of Contract is Contract of Indemnity

In M Shah Singh v. State of Mysore case,\textsuperscript{70} the Appellant (M. Sham Singh) has applied to the Government of Mysore on September 11, 1946 for an overseas scholarship. The overseas scholarship was sanctioned in his favour. The appellant was also required to execute a bond in favour of the Government of Mysore for availing the overseas scholarship. The appellant executed the bond in the favour of Government of Mysore on July 2, 1947. As per the terms of the bond, the scholar had to accept and be bound by all the conditions specified in the rules. The relevant excerpts are as follows:

“On completion of the study or research course, the scholar shall return to the Mysore State, and if and when called upon to do so, serve the Government for a period of not less than

\textsuperscript{70} AIR 1972 SC 2440
five years, on such salary as Government may, in their sole discretion fix, provided that, if within six months after his return to Bangalore, Mysore State Government do not find employment for him they shall be deemed to have waived their right to claim his services as aforesaid and the scholar shall, thereafter, be at liberty to seek employment elsewhere”.

“That in case the scholar fails to fulfill any of the first two conditions herein set forth or specified in the aforesaid rules he shall refund to Government the amounts received by him as scholarship, passage money and all other amounts that may be advanced to him up to the date of his return to the Mysore State in connection with the aforesaid course of study or research with such interest not exceeding 5 per cent per annum as Government may, at their option, fix and demand. But if he fails to fulfill the third condition, viz. joining duty under and serving the Government for a period of five years, after completion of the terms of scholarship or deputation he shall pay on the aggregate amount to be refunded as aforesaid, enhanced interest at 9 percent per annum, instead of 5 percent as mentioned above and a penalty of not less than one year’s salary for each period of deputation”

After the completion of all formalities, the appellant left for USA for study in the Polytechnic Institute of Brooklyn, New York in September, 1948. On July 25, 1949 the request of the appellant to be permitted for stay in USA for practical training with the General Electric Company for a period of one year at his own expenses beyond September 30, 1949 was conveyed through The Education Secretary, Embassy of India in U.S.A. to the Chief Secretary, Government of Mysore by a letter. The request of the appellant was also supported by the Education Secretary, Embassy of India in USA stating that the training would be very valuable for the appellant as General Electric Company is a well-known name. The Government of Mysore granted the request. A letter was also forwarded to the appellant from the Secretary, Government of Mysore that the appellant is permitted to undergo the practical training for one year beyond September 30, 1949 at his own expense.

The studies of the appellant got completed on September 1949 and the appellant obtained the diploma on June 14, 1950. Though the facts are silent whether the appellant was undergoing training with the General Electric Company during this period.
The appellant returned from U.S.A to India (Bangalore) on July 06, 1950. It appears that the appellant was undergoing his training and he left the training in between and returned to India (Though facts are silent). The appellant wrote a letter to the government of Mysore on July 18, 1950 stating his return from the U.S.A. after completion of his studies. He wrote another letter to the Government of Mysore on November 29, 1950, seeking permission for return to USA for the completion of his training, which was interrupted on account of his return to India due to ill health of his mother. In his letter the appellant clearly stated that he would make himself available for the services to the Mysore Government on his return to India from training. He further stated that his visit to the USA would be at his own cost and no financial assistance would be taken by him from the Mysore Government. The Mysore Government acceded to his request on the condition that he would serve the Government of Mysore for a period of 5 years after his return.

After receiving of the approval/permission from the government of Mysore the appellant left for U.S.A on February 27, 1951. Thereafter the appellant never returned to India and continued to stay in the U.S.A. after taking employment as Director of Tourist Office at San Francisco.

The suit was filed by the Mysore Government in the trial Court of Mysore for the recovery of Rs.40000/- for the breach of the bond executed by the appellant in favour of the Mysore government. The trial court dismissed the suit on the ground that on his return to India, the Mysore government did not provide any job to the appellant within a period of six months; therefore the appellant was now free to seek employment anywhere. The Mysore government therefore cannot ask for recovery of any money from the appellant. The trial court said that the previous Contract stood discharged on January, 1951 (Since six months from the time of his return on July, 1950 expired on January, 1951). The order of the Mysore Government dated February 25, 1951 was a fresh Contract that was without consideration. On appeal to the High Court, Mysore, the High Court71 reversed the order of the trial court and decreed the suit against

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71 The High Court proceeded to say:
“if under these circumstances, the State Government agreed to the request to extend the period of stay for one year and subsequently permitted defendant No. 1 to return to U.S.A. in pursuance of proper commitment under a mutual agreement, to complete his training we have no doubt in holding that the request made by defendant No. 1 and granted by the plaintiff form one integral part of the Contract, the performance of which by defendant No. 1 had been extended by mutual consent. It is regrettable that
the appellant. Thereafter, an appeal was filed by the appellant to the Hon’ble Supreme Court by way of a special leave.

The Hon’ble Supreme Court agreed to the reasoning of the High Court, which said that the return of the appellant was on July 06, 1950 was due to the illness of the appellant’s mother and it is clear from the letter dated November 27, 1950 that he had not completed his practical training with the General Electric Company and that he wanted to return for its completion. The Hon’ble Supreme Court was of the view that under such circumstances, it would not have been feasible for the government to offer any employment to the appellant, with in the period of six months from his return. The Hon’ble Supreme Court also reiterated the assurance made by the appellant in his letter dated November 27, 1950 that he would make himself available for the job with the Mysore Government on his return. The Hon’ble Supreme Court held that the appellant was bound under the terms of the bond to first make his services available at the disposal of the Mysore Government. The appeal by the appellant therefore fails and is dismissed with costs.

According to the researcher, the terms of the bond were very clear that the appellant had to complete the course and post completion he shall return to India, if there was a breach in this condition viz. by way of non-completion of the course and return to India or completion of the course and not return to India or non-completion and non-return the Mysore Government was entitled to recover the amount from the appellant by way of an Indemnity Bond executed by him in favour of the Mysore Government. In the present case, the appellant was entitled to repay all the amounts received by the appellant as scholarship, passage money and all other amounts that may be advanced to him up to the date of his return to the Mysore government with such interest not exceeding 5 per cent per annum. An enhanced rate of 9% per annum would be charged in case the appellant did not join and serve the government of Mysore. According to the researcher the question of enhanced rate of 9% per annum does not apply in the present case, as the government of Mysore did not call upon the appellant to join and serve the government of Mysore, since there was no such thing, the question of not joining and serving does not arise. The question of interest here is that the appellant must have completed his course and must have returned to India. In the given case, as per the facts of the case, the appellant was required to

having secured the benefits of foreign technical education at the cost of the State exchequer, defendant No. 1 has adopted an attitude in the suit, in utter disregard of his legal and moral obligations under the scholarship bond.”
return to India on completion of this diploma course on September 30, 1950. Since the appellant had already taken permission from the government of Mysore to pursue one year practical training at General Electric Company at his own cost beyond September 30, 1950. Accordingly the appellant was required to return to India on completion of his practical training on September 30, 1951; and on conveying about the factum of his return to India to the Mysore government should have waited for a period of six months\textsuperscript{72} for any offer of employment, but this did not happen. The appellant returned to India before the completion of his practical training to India. According to the terms of the bond or letter by the Mysore government permitting the appellant to undergo practical training, it can nowhere be said that the appellant was bound to complete the “practical training”, more so because the expenditure of the practical training was borne by the appellant himself. What was of concern to the Mysore government was the factum that the course under scholarship must be completed by the appellant and post completion he must return to India, which according to the researcher the appellant did. The appellant did convey of his return to India to the Mysore government, though he had not at that point of time completed his “practical training” with General Electric Company. Under such circumstances, the appellant should have waited for six months period from the date of his return in India for an offer of a Job by the Mysore government. The appellant before the lapse of this six months period from the date of his return to India wrote to the Mysore Government for allowing the appellant to complete his practical training in USA, the appellant reiterated in the letter that he would make his services available to the Mysore Government when he next return to India. This expenditure for the visit was to be borne by the appellant himself. According to the researcher the appellant would not have been bound by the terms of the bond, if he would have not written any letter (on November 29, 1950) and returned to USA on February 27, 1951, since the six months’ time from the date of his return to India (July, 1950) elapsed on January, 1951. The appellant committed a blunder by seeking permission for his return to USA for the completion of the remaining practical training, and reiterating himself that he would make his services available to the Mysore government on his next return. The Mysore government acceded to the appellant’s request at his own cost, with a condition that “he should serve the government of Mysore for a period of 5 years after his return”. According to the researcher, there appears a lacunae in this condition laid down by the Mysore government. The condition is silent on the factum of his

\textsuperscript{72} From the date of return to India.
return whether immediately after the completion of training or not. This leaves it open for the court to interpret what does “return” in the given context signify. From the facts of the case, the appellant took employment in San Francisco, as Director of the Tourist Office and never returned. Under the given circumstances, the appellant got bound because of his own letter sent to the Mysore government requesting the government to allow the appellant to finish his practical training at his own cost and reiterating that he would make himself available for job after his return. Therefore, his failure to return to India, entitles the government of Mysore, under the bond to claim for the recovery of the amount spend by the government from the appellant. The decision of the Hon’ble Supreme Court is correct though the reasons given by the researcher in arriving at the decision differs from that of the Hon’ble Supreme Court. The decision is also silent on the amount which the appellant is liable to pay to the Mysore government; the case was dismissed with costs.

3.5.7 Indemnified --Payment Made as Under Reserve

In United Commercial Bank v. Bank of India and Others case\(^73\) Messrs. Godrej Soaps Limited (respondent no.2, hereinafter referred to as plaintiff) entered into a Contract with Bihar State Food and Civil Supplies Corporation Limited (respondent 3, hereinafter referred to as Corporation) for the supply of one thousand metric tonnes of “Sizola Brand pure Mustard oil” to a tune of Rs.86 lakhs approximately. Under the Contract of sale, the Corporation was required to open a letter of credit for the said amount, with the United Commercial Bank (hereinafter referred to as appellant bank), which the Corporation accordingly did. The confirmed irrevocable letter of credit was issued by the appellant bank in favour of the plaintiffs. The plaintiffs dispatched the mustard oil to various destinations, according to the schedule attached with the letter of credit. The documents were presented by the plaintiffs in the lots of two for payment by the appellant bank. First lot consisted of 20 sets of documents for Rs.36,52,960. Second lot consisted of 27 sets of documents for Rs.49,31,496. Both making to the total payment of Rs.85,84,456.

The appellant bank, refused to make payment to the plaintiffs on the ground of discrepancies in the documents presented by the plaintiff to the bank. With respect to the first lot

\(^73\) AIR 1981 SC 1426
of documents the appellant bank, refused to make the payment “except under reserve” to the plaintiffs. The appellant bank stated that the railway receipt described the goods as “Sizola Brand Pure Mustard Oil ‘Unrefined’” whereas the letter of credit stated “Sizola Brand Pure Mustard Oil”. The plaintiffs accordingly instructed their bankers (Bank of India) to accept the payment of Rs.36,52,960 against the first lot of documents, under reserve. The same was credited to the account of the plaintiffs by their banker with the specific notation that it is paid under reserve on account of discrepancies.

Second lot of documents was presented to the bank on July 3, 1978 for the payment. The payment for the second lot of documents was refused by the appellant bank on the ground of discrepancy and that some of the railway receipts were stale. The plaintiffs made a request to the Central Railways for the deletion of the word “Unrefined” from the railway receipt.

On July 12, 1978 the appellant Bank wrote a letter to the Bank of India for the refund of the amount of Rs.36,52,960 paid under reserve in respect of the first lot of documents on the ground that the bills were not acceptable to the Corporation due to discrepancies. The appellant bank also asked for an interest of 5% from the date of payment made to Bank of India by United Commercial Bank to be paid back by Bank of India to United Commercial Bank. The appellant bank also conveyed to the plaintiffs on the same day, that the appellant bank would not be making payment with respect to second lot of documents because the documents were not acceptable due to the discrepancies. The plaintiffs wrote a letter74 to the appellant bank the next day i.e. on July 13, 1978 regarding the first lot of documents that the use of the word “unrefined” in the railway receipt should not be treated as a discrepancy, it forwarded the copy of the telegrams sent by the Central Railway, deleting the word “unrefined”. The plaintiffs also requested for the payment with respect to the second lot of documents.

74 Excerpts, “On July 13, 1978 the plaintiffs addressed the following letter to their bankers, the Bank of India:
We are enclosing 19 documents as referred to above and request you to forward the same to the United Commercial Bank, Nariman Point, Bombay for negotiations of payment.
We request you to collect these funds forthwith and credit our Cash Credit Account No. 1 with you.
We have complied with all the terms and conditions of the Letter of Credit and feel that United Commercial Bank would make the payment to you without reserve. You may accept the payment under reserve if insisted upon by them....”
On the same day, the plaintiffs also wrote to the corporation, stating that the use of the word “unrefined” has no bearing to the quality of the oil and it was used for the purpose of lowering down the freight. It also said that the railway authorities had agreed to amend the railway receipt by deleting the word ‘Unrefined’.

On the same day the plaintiffs also wrote to their bankers, Bank of India, for forwarding the second lot of documents to the appellant bank for payment without reserve, and that if the appellant bank insisted on payment under reserve, then Bank of India to accept the payment under reserve. The Bank of India accordingly did so, stating “we would accept payment under reserve.”

On July 14, 1978 the appellant bank wrote to the Bank of India, stating that they are returning the second lot of documents and the appellant’s bank inability in negotiating the documents due to discrepancies. It further said that deletion of the word “unrefined” would not serve the purpose as it would not make the railway receipt clean. It also stated that some of the railway receipts were stale. It also stated that it could lift the reserve without obtaining prior permission of their constituents (the corporation).

Since the appellant bank had already made the request to the bank of India of remitting the payment made with reference to the first lot of documents, the plaintiffs, being apprehensive that the Bank of India would refund the amount, the plaintiffs kept a plaint ready on July 17, 1978 for the grant of perpetual injunction against the appellant. On the same day, the plaintiff wrote a letter to the appellant bank for payment with reference to the second lot of documents,

Excerpts of the letter,
“………the sets of documents (19 & 8) is regarding the appearance of the word ‘unrefined’ in the railway receipts, as the same word does not appear in the Letter of Credit along with the words "Sizola Brand Pure Mustard Oil". Out of abundant precaution, we then obtained and gave you copies of telegrams issued by the Central Railway to the Station Masters of the various destination stations, to which the goods were booked, to the effect that the word "unrefined" is superfluous and, therefore, deleted. You have taken the stand that by this action of the Central Railway also the documents still does not continue to be in accordance with the letter of credit.
Out of abundant precaution, we are now submitting herewith the railway receipt returned by you wherein the word “unrefined” has been physically deleted by the railway authorities.
We are also enclosing a letter of undertaking which is letter of undertaking issued by our bankers, the Bank of India, in your name indemnifying you against demurrage, wharfage and such other charges which you may have to pay at various destinations, where the goods have been consigned. This action of ours is without prejudice to any of our rights and contentions.
We now request you to pay for these documents forthwith.” The Bank of India executed a Letter of Indemnity or Guarantee to the effect.
enclosing a Letter of Guarantee or Indemnity executed by their bankers (Bank of India). Under the Letter of Indemnity or Guarantee, the plaintiffs “unconditionally” agreed to hold the appellant bank harmless and indemnified for all consequences of non-acceptance and/or nonpayment of the bills exchange”. “We have made arrangements for due payment of this/these bills.” The plaintiffs also unconditionally agreed to reimburse and on demand the equivalent of the above mentioned bills together with all other expenses, demurrage and all such other charges incurred by the appellant bank in connection of the dishonored bill. The liability was restricted to Rs.86,00,000/- apart from charges enumerated above and will remain in force till 17.08.1978. Unless the claim in writing is made to the plaintiffs, before the above mentioned date, the plaintiffs would be relieved and discharged from all liability there under. This Letter of Indemnity was given by the Bank of India on behalf of the plaintiffs. Since the arrangements for due payment of the bills were already made, it can be construed that the corporation had agreed to retire the bills of exchange.

On July 19, 1978 the representative of the plaintiff met with the representative of the appellant bank, where the representative of the appellant bank stated that the first lot of documents have not been accepted by the corporation due to discrepancy, therefore a demand for the refund of the amount with reference to first lot of document was made by the appellant bank. Secondly, with reference to the second lot of the document, instruction from the head office is awaited and would come today.

On the same day i.e. on July 19, 1978, the plaintiffs brought the suit in the Original Side of the Bombay High Court, along with an application for the grant of a temporary injunction to restrain the appellant from recalling the amount of Rs.36,52,960. The learned Single Judge Bench declined to grant an exparte interim injunction. The appellant bank came to know that the plaintiff has instituted a suit. The plaintiff then through his representative gave an endorsement at the foot of the letter dated July 17, 1978, that the plaintiff hereby undertakes not to proceed with the suit and dated the endorsement as 19.07.1978.

The appellant bank made a payment of Rs.49,31,496, in terms of the Letter of Indemnity, on the faith of the undertaking. It was conveyed to the plaintiffs by Bank of India,
through their letter dated July 20, 1978 that the money has been credited to the plaintiff’s account under reserve.

The appellant bank asked for the refund of the total amount of Rs.85,84,456 together with interest of 15% from the date of payment to the date of refund on August 2, 1978, on the grounds that the bills of exchange had not been accepted by the corporation due to discrepancies. The bills of exchange were dishonored on August 2, 1978 on the grounds that the railway receipts accompanying the bills were stale, goods supplied were not as per terms of the agreement and the oil was not fit for human consumption as per the chemical analysis.

The Bank of India conveyed to the plaintiffs on August 4, 1978 that the appellant bank has asked for the repayment of the total money of Rs.85,84,456 paid under reserve and in terms of its Letter of Guarantee or Indemnity, seeking their ‘instructions’ in the matter.

The plaintiffs moved the learned Single Judge (at his residence) on Sunday, August 06, 1978 seeking for an ex-parte ad interim injunction, restraining the appellant from recalling or receiving the amount due from the Bank of India on the ground that Bank of India would make the payment of the sum on August 7, 1978 on the commencement of the banking hours, unless an injunction is granted; the injunction was accordingly granted. On December 17, 1978 a court receiver was appointed by the learned Single Judge for sale of goods without any obligation to the purchaser as to quality, quantity or edibility of the said goods. The offer made by the plaintiffs for the purchase of the goods was accepted by the receiver for a tune of Rs.18,53,000 on March 27, 1979. On April 04, 1979 the sale was confirmed by the High Court.

The temporary injunction was made obsolete by the order of the learned Single Judge dated August 24, 1979 till the disposal of the suit. The court said that the appellant were not

“….We hereby ‘unconditionally’ agree to hold you harmless and indemnified for all consequences of non-acceptance and/or non-payment of this/these bill(s) exchange by reason of the following discrepancies claims by you:

..... ..... ..... 
We have made arrangements for due payment of this/these bill(s).

We further unconditionally agree that in the event of the bills being dishonoured on due presentation on account of the above discrepancies claimed by you to reimburse and on demand the equivalent of the above mentioned bill(s) together with all other expenses, demurrage and all such other charges incurred by you in connection with dishonoured bill(s)…..our liability under this bond is restricted to Rs.86 lakhs…..”

77 Misleading contention by the learned counsel,

“The said interim order makes it absolutely clear that our clients will in no way be liable and responsible to return the amounts received under reserve and therefore our clients are in no way liable to pay any sum to
entitled to “unilaterally impose” condition of payment under reserve or to refuse pay on ground of discrepancies, nor they could reject the document as stale, as there were no stale documents. The court held that plaintiffs had a prima facie case. Though the court added a rider, under which it said that Bank of India is left free to decide whether the conditions for payment under the Letter of Indemnity have been satisfied or not, so as to justify payment to the appellants. Secondly, the appellants are not restrained from making a claim upon the Bank of India under the Letter of Indemnity nor were the Bank of India restrained from making payment.

The appellant bank filed an appeal to the Division bench of the High Court on August 24, 1979 on being aggrieved by the order of the Single Judge. But the Division bench summarily dismissed the appeal on October 17, 1979.

On August 24, 1979 the plaintiffs through his solicitor wrote to the Bank of India regarding order of the Single Judge granting injunction and instructed it not to pay. The letter stated “our clients will in no way be liable and responsible to return the amounts received under reserve and therefore our clients are in no way liable to pay any sum to UCO Bank and therefore you are also not liable at present to pay any sum to UCO Bank under the said Letter of Indemnity….if any payment is made by you, it will be entirely at your risk and peril”

The appellants again made a demand for the total sum of money through its letter dated August 31, 1979. The Bank of India through it letter dated October 16, 1979 refused to make the payment, and refereed to the order passed by the learned Single Judge. The letter further stated that there is no provision of staleness in the letter of credit, and it is not open to the corporation to recall payment on that ground. It stated that according to the order, the dishonor was not due to any discrepancy but the fact that the bills were not duly presented. It further said that the appellants have not appealed against the order and since the appellants have not complied with the terms of the Indemnity, the Bank of India stated its inability in making the payment against UCO Bank and therefore you are also not liable at present to pay any sum to UCO Bank under the said letter of Indemnity. In the circumstances, it will not only be improper but illegal for you to make any payment to UCO Bank.

In the circumstances, we have been instructed by our clients to request you which we hereby do, not to make any payment to UCO Bank. In spite of what is stated herein, if any payment is made by you to UCO Bank, the same will not be binding on our clients and you will not be entitled to debit such amount to our clients current account with you and our clients will refuse to reimburse you any sum so wrongfully paid by you. Please note that if any payment is made by you, it will be entirely at your risk and peril.”
the order of the division bench of the High Court dated October 17, 1979. An appeal was made by the appellant bank by way of a special leave\textsuperscript{78} to the Hon’ble Supreme Court.

The Hon’ble Supreme Court in agreement with the cases put forward, stated that opening of an irrevocable/confirmed letter of credit constitutes a bargain between the seller and the banker, which imposes an absolute obligation on the banker to pay. However, it is also equally true, that the banker is not under an obligation to pay unless the accompanying documents so submitted to the bank are in exact compliance of the terms of the letter of credit. Such documents must be meticulously scrutinized with utmost care. Once the documents meet the terms of the letter of credit, the banker is bound to make the payment irrespective of any dispute between the buyer and seller with reference to goods in question. In case the bank fails to honour the letter of credit/ bills of exchange on the production of proper documents it would amount to repudiation of the Contract and the sellers would be entitled to damages arising out of such breach. If the documents so presented are not in accordance of the terms of the letter of credit, the paying bank can refuse payment and the beneficiary cannot claim against the paying bank. It is the description of the good that is all important. Banks are not concerned with the sales contract or the goods. The fulfillment of the terms of the sales contract is a matter for the seller and the buyer alone. Credits, by their nature, are separate transactions from the sales or other contracts on which they may be based and banks are in no way concerned with or bound by such contracts. In documentary credit operations all parties concerned deal in documents and not in goods. A letter of credit constitutes the sole Contract with the banker, and the bank issuing the letter of credit has no concern with any question that may arise between the seller and the purchase of the goods, for the purchase price of which the letter of credit was issued. There is no room for documents which are “almost same”. The description of the goods in the relative bill of lading must be the same as the description in the letter of credit. The liability imposed on the issuing bank carries with it a corresponding right that the seller shall, on his part, comply with the terms of the letter of credit and the seller’s obligations have been construed as strictly as those of the banker. According to the Hon’ble Supreme Court, the appellant bank was under the duty to its constituent (Bihar Corporation) to scrutinize the accompanying documents and the appellant

\textsuperscript{78} Under Article 136 of the Constitution of India. In the present case, the Supreme Court, entertained the appeal, but said “The Court’s powers under Art. 136 of Constitution are untrammeled, but they are subject to self-ordained restrictions. The Court does not, as a matter of rule, interfere with interlocutory orders, save under very exceptional circumstances.”
bank could not be compelled to make payment in case of any discrepancy. The appellant bank was fully entitled to exercise its judgment for its own protection. The bank therefore paid the money under reserve. According to the Hon’ble Supreme Court, the remedy which was available to the plaintiffs was to approach the Corporation, to instruct a change in the letter of credit from “Sizola Brand Pure Mustard Oil” to “Sizola Brand Pure Mustard Oil “Unrefined.” The plaintiffs did not opt for this course of action; rather they preferred executing a Letter of Guarantee or Indemnity for getting over the irregularity in description, so that the payment could be made in their accounts. Accordingly, when the bills of exchange which were presented to the Corporation for payment, they were dishonored on August 3, 1978. The legal consequences followed between the appellant bank and the Bank of India and the amount became immediately payable on demand. Coming to the issue, the Hon’ble Supreme Court stated that it is unfortunate that the High Court granted temporary injunction in this case, in terms of the Letter of Guarantee or Indemnity executed. According to the Hon’ble Supreme Court, “If such temporary injunctions were to be granted in a transaction between a banker and a banker, restraining a bank from recalling the amount due when payment is made under reserve to another bank or in terms of the Letter of Guarantee or Credit executed by it, the whole banking system in the country would fail.”

The Hon’ble Supreme Court held that the Court under Article 136 does not as a matter of rule, interfere with the, interlocutory orders, save under very exceptional circumstances. Further Court said that the order of temporary injunction passed by the High Court on the ground of “prima facie case” was highly unwarranted. Because, according to the Hon’ble Supreme Court, the High Court did not go into the question of “balance of convenience” and “irreparable loss” to the plaintiff, if no injunction was granted. Further, as per the material on record, the Hon’ble Supreme Court was of the opinion that there did not exist any prima facie case. It said that, had the suit for injunction be brought by Bank of India; the High Court could not have granted the same as it was bound by the terms of the Contracts. Accordingly, what could not be not be achieved directly, it could not be achieved indirectly by the plaintiffs. Explaining the meaning of

79 The Court relied upon decisions in Hamzeh Malas and Sons v. British Imex Industries Ltd. [1958] 2 Q.B. 127 and Urquhart Lindsay and Co. Ltd. v. Eastern Bank Ltd. [1922] 1 K.B. 318 and observed at p. 930 of the Report, that the refusal of the bank to honour the bills of exchange drawn by the seller on presentation of the proper documents constituted a repudiation of the Contract as a whole, and the sellers were entitled to damages arising from such a breach. Tarapore and Co., Madras v. Tractors Export, Moscow and Anr. [1969] 2 S.C.R. 920 relied.
“under reserve”, the court said, that “A payment under reserve is understood in the banking transaction to mean that the recipient of money may not deem it as his own but must be prepared to return in on demand.”\textsuperscript{80} The Hon’ble Supreme Court after stating so stated that in the given case, the balance of convenience lied in favour of allowing the normal banking transaction to go forward. The plaintiffs also failed to prove that they would suffer an irreparable loss if the injunction was not granted in their favour. The Hon’ble Supreme Court did not entertain the contention put forward by the plaintiffs that the balance of convenience lie in favour of them, since they had executed a Letter of Guarantee/ Indemnity in favour of the appellant bank, in case of loss and it would amount to serious credit-freeze, if the plaintiffs were asked to repay the amount on being recalled by the appellant bank. It concluded by saying that there was no justification for the High Court to grant a temporary injunction. The order granting temporary injunction, restraining the appellant to recall money from the Bank of India is set aside. The High Court was directed to dispose of the suit expeditiously, within six months from the date of order. The appeal therefore succeeded and was allowed with costs. The costs of the appellant shall be borne by the Bank of India and Godrej Soaps Pvt. Ltd.

The researcher is of the view that the facts of this case are somewhat complicated. In the given case, the payment was to be made under the letter of credit for a sum of Rs. 86 lakhs approximately. The claim was made by way of two lots of documents. In case of the first lot of document, the payment was made under reserve by the appellant bank, since the documents were not in conformity with the letter of credit. On 12.07.1978, request for the refund of the money paid under the first lot of documents was made by letter of the appellant to the plaintiffs on the grounds that the bills were not acceptable to the corporation. But the money was not paid to the appellant bank. On the contrary the plaintiffs tried to clarify their stand with reference to the first lot of documents and asked for payment of the second lot of documents vide letter dated 13.07.1978. On 14.07.1978 the appellant showed its inability to make the payment. On 17.07.1978, it again asked for the payment of second lot of documents on an undertaking for Indemnity, the Letter of Indemnity accordingly got executed by the bankers of the Plaintiffs. On

the basis of the undertaking, the payment was made under reserve by the appellant bank for the second lot of documents on 20.07.1978. On 02.08.1978, request of refund of the total amount paid under reserve was made in terms of Letter of Guarantee/Indemnity on the ground that bills were not accepted by the corporation. It appears that the bank was not clear of its stand, when the bank knew that the bills of the first lot has not been accepted by the corporation, it would in no case be safe to make the payment of the second lot of documents which suffered from discrepancy. The pivot, around which the payment by the appellant bank for the second lot of document is made, rests on the “Letter of Indemnity/Guarantee” executed by the bankers of the plaintiffs in favour of the appellant bank. According to the researcher, the bank should not have made the payment to the Bank of India. The appellant bank was right in refusing payment on the grounds of discrepancy in the railway receipt. However, if as a matter of practice the payment was made to the Bank of India, the appellant bank was within rights in recalling the total money paid under reserve in terms of Letter of Indemnity/Guarantee.

Under the order of the learned Single Judge, which granted ex-parte interim injunction against the appellant bank and in favour of the plaintiffs, the learned judge added a rider to his order, where he by clearly emphasizing the significance and importance of the Letter of Indemnity/Guarantee said that Bank of India was left free to decide on the matter whether the conditions of the Letter of Indemnity have been satisfied or not. And appellant is not restrained from making a claim in terms of the Letter of Indemnity nor is Bank of India restrained from making payment there under. According to the researcher the Bank of India was under an obligation to pay the money to the Appellant bank both under the letter of credit and Letter of Indemnity. As per the terms of the Letter of Indemnity/Guarantee the plaintiffs through their banker agreed to unconditionally hold harmless and indemnify for all consequences of non-acceptance and/or non-payment of the bills of exchange by reason of discrepancies claimed by them. Discrepancy in the railway receipt was one of the major concerns for not accepting of the bills of exchange by the corporation for payment. The appellant bank could very well evoke the Letter of Indemnity in its favour. Further, it appears on the face of it that there existed

Rider – “(1) the Bank of India was left free to decide whether or not the conditions for payment under the letter of Indemnity had been satisfied so as to justify the making of payment there under to the appellant, and (2) the appellant was not restrained from making a claim upon the Bank of India or from receiving from it the amount payable in terms of the letter of Indemnity nor was the Bank of India restrained from making payment there under.”
discrepancies in communication between various parties. The rider aspect of the order of the Learned Single Judge was not communicated to other parties by the plaintiff. Rather, it was modified by the plaintiff’s in such a way to suit its stand. Their bankers were instructed not to make the payment stating that the plaintiffs were not liable to pay, though according to the researcher this was not the case. The order was only restraining the appellant bank to proceed against the Bank of India for payment. It did not refuse on its liability, rather by way of adding a rider to the order; it left free on the Bank of India to decide on matter of payment if the conditions of Indemnity were fulfilled. However, this was not communicated to the Bank of India. Another discrepancy which appears is with respect to the communication made by the Bank of India to the appellant bank refusing payment on the basis of the injunction order passed by the learned Single Judge stating that letter of credit had no provision regarding the staleness of receipts, secondly discrepancy was not made a ground for dishonor of bills, rather the ground of dishonor was that they were not duly presented, and thirdly, the terms of Indemnity have not be complied with. The excerpts of the order do not mention the above mentioned things. Further, the researcher is of the view that an aspect which need to be addressed is that what does staleness of the document mean; this issue was not dealt by the Hon’ble Supreme Court.\textsuperscript{82} According to the researcher if the presentation of the documents is made before the expiry of the letter of credit, the document would not be said to be stale, unless the practice or Contract specifies a lower limit. In the given case the documents don’t appear to be stale as the documents were presented before the expiry of the letter of credit. The researcher is of the view that in all the documents so presented discrepancy existed with respect to the contents of the documents which existed on the railway receipt and one that existed on the letter of credit. On the basis of this discrepancy, the bank was right in refusing payment. The Bank was also right in making the payment of the second lot of documents on the basis of the Letter of Indemnity/ Guarantee executed by the Bank of India (in which they said that they have made due arrangements for the

\textsuperscript{82} But, the Hon’ble Supreme Court, referred to, Credits, Sixth edn. p. 21, the nature of the obligation created by a banker’s commercial credit is succinctly stated. A seller of goods relying on such an instrument believes that he has ‘the direct obligation of the issuing bank running in his favour, enforceable by him against that bank, that it will pay his drafts if drawn in compliance with the terms of the letter of credit’. Banks are not concerned with the sales Contract or the goods; if it were otherwise credit business would be impossible. Banker’s commercial credits are almost without exception everywhere made subject to the code entitled the ‘Uniform Customs and Practices for Documentary Credits’, by which the General Provisions and Definitions and the Articles following are to "apply to all documentary credit and binding upon all parties thereto unless expressly agreed".
payments of the bills). It is correctly stated that in such transactions, the accepting bank can only claim Indemnity if the conditions on which it is authorized to accept with respect to the accompanying documents are strictly observed. The appellant bank was also right in recalling for money paid under reserve in terms of the Letter of Indemnity/Guarantee, as the bank had strictly observed the conditions on which the appellant bank was authorized to accept the accompanying documents. The Hon’ble Supreme Court agreed to the fact that the letter of credit is analogous to the Contract of Guarantee. On the aspect of the grant of interim/ temporary injunction by the learned Single Judge, the researcher is in agreement with the view of the Hon’ble Supreme Court that such order of the learned Single Judge is highly unwarranted because under such transactions the courts generally do not interfere with such orders. But if the courts interfere except under exceptional circumstances, the whole credit machinery would come to a halt. Further before granting the temporary injunction the court must see whether there exists a prima facie case, whether there exists a balance of convenience in the plaintiff’s favour, whether the non-granting of injunction would cause irreparable loss to the plaintiff, the High Court without going in the above questions granted the temporary injunction on the plea that there exist a prima facie case. According to the Hon’ble Supreme Court, the balance of convenience lies in favour of allowing the bank to move forward in the transaction. The plaintiffs also failed to prove irreparable loss to them; the injunction was not granted to them, under such circumstances, the Single learned Judge was not right in granting the temporary injunction exparte. With respect to power of Hon’ble Supreme Court to interfere with the interlocutory orders under Article 136, the court clearly stated that it does not as a matter of rule interfere with the interlocutory orders except in exceptional circumstances. This case was covered under the exceptional circumstances. The order of the High Court was set side and the appeal therefore succeeded. The crux of the matter lie that it was the Letter of Indemnity/Guarantee which was fundamental in getting the payment from the appellant bank, though under reserve.

3.5.8 Motor Vehicle Insurance as a Contract of Indemnity

In Narcinva v. Kamat and anr. etc. v. Alfred Antonio Doe Martins and Ors case, the Hon’ble Supreme court has interpreted the meaning of ‘any other person’ on the facts. Oriental Fire and General Insurance, a nationalized company having monopoly in general insurance

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83 AIR 1985 SC 1281
insured the pick-up van which belonged to M/s Narcinva V. Kamat, a partnership firm carrying on business at Margao, Goa. On May 17, 1976 around 10:30 A.M. an accident took place by that pick-up van, in which two people were injured. One of them succumbed to injuries and the other survived. The action was brought by way of two petitions, one by the heirs of the deceased and other by the other injured person, in the Motor Accident Claims Tribunal, for compensation. The Tribunal held the partnership firm liable for Rs.75000 as compensation to the heirs of the deceased and Rs.3000 to the other. The Insurance Company in the said proceedings contended that the insurance company is not liable to pay as the terms of the policy were not adhered to, under which the person driving the vehicle must hold a driving licence. In the given case, the person driving the vehicle was one of the partners Narcinva Kamat who was the owner of the vehicle, did not produce the valid license when asked for, it was construed by the Tribunal that he did not have a valid driving license. Accordingly, the Tribunal held that there were a breach of conditions of the terms of policy and hence the insurance company was not liable. On the other issue, the Tribunal again held in favour of the insurance company, under which the insurance company contended that the liability of the insurance company is to the extent of Rs.50000/- under section- 95 of the Motor Vehicles Act, 1988 and the policy in force. Two appeals were preferred by the partnership firm and its partners against the decision of the Tribunal, in the division bench of the Bombay High Court. The Division bench agreeing to the decision of the Tribunal dismissed the appeals. On the dismissal of the appeals, the firm and its partners approached the Hon’ble Supreme Court of India by way of a special leave.

The issue under consideration does not relate to the quantum of compensation to be awarded, but the issue under consideration was whether the insurance company is liable to pay compensation or not? It has not been disputed that the pick-up van belonged to the partnership firm and that Narcinva is the partner of the firm. It was contented in the Tribunal and the High Court by the appellants that the van was driven by one Mr. Pandu Lotlikar but as per the concurrent findings of the Tribunal and the High Court, the van was driven negligently and rashly by the partner. The Hon’ble Supreme Court accepted the findings. The accident took place and Sita and Ida suffered injuries. Ida succumbed to injuries but Sita survived. The Hon’ble
Supreme Court looked into the excerpts\textsuperscript{84} of the policy, on which the High Court based its decision.

One Mr. Jaimo Albert was examined on behalf of the insurance company, he admitted that the “insurance policy was a comprehensive policy meaning thereby that the insurance company would be liable to satisfy the claim of damage arising out of the use of the vehicle.” The representative did not speak of any other terms of the Contract of insurance. Considering the above admissions and the necessary excerpts of the policy (mentioned above), the Hon’ble Supreme Court went on to decide the question, whether the insurance company was liable to pay the amount of compensation. To decide the given issue the Hon’ble Supreme Court divided the issue into two questions; it first went on to decide whether the partnership firm was liable to pay? The Hon’ble Supreme Court relied on Section 18, 12 and 26 of the Indian Partnership Act, 1932 under which each partner of the firm is the agent of the firm as well as the other partner; Every partner is entitled to attend diligently to his duties in the conduct of the business; Where by the wrongful act or omission of a partner acting in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party, or any penalty is incurred, the firm is liable therefore to the same extent as the partner. The Hon’ble Supreme Court decided that it can be inferred in the given circumstances and from the above provisions that the car which belonged to the partnership firm was driven with the permission of the owner or with its implied authority.

The other question which the Hon’ble Supreme Court decided was, whether the partner had a driving license at the relevant time? As per the Tribunal records, the vehicle in question was insured as a private carrier. The representative of the insurance company has also admitted that the insurance policy was a comprehensive policy. Now, coming to the question, the Hon’ble Supreme Court looked into the contentions of the Insurance Company under which it said that that the partner who was driving the vehicle didn’t have a valid driving license. The Hon’ble Supreme Court said, in case of breach of contracts, the burden lies on the party who alleges breach, to prove that the breach has taken place, in the given case the burden was on the

\textsuperscript{84}“Driver: Any of the following; (a) (deleted in type) (b) any other person provided he is in the insured’s employment and is driving on his order or with his permission; Provided that the person driving holds a license to drive the Motor Vehicle or has held and is not disqualified from holding or obtaining such a license”.

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insurance company to prove that the partner driving the van did not have a driving license. The burden is such that unless proved by evidence, the party alleging breach would fail. The simple failure of the appellant (partner driving the van) to produce the license when asked for in the cross examination would not lead to an adverse inference that he didn’t have a license and would not absolve the insurance company from its liability to pay. The inability of the appellant to produce driving license at the time of cross examination does not lay any obligation of the appellant to produce the driving license. It was for the insurance company to provide evidence, for that they could have approached the R.T. which issues and renews driving license and got evidence to substantiate its stand. Since no evidence is given by the insurance company, the insurance company fails.

The Hon’ble Supreme Court stated that the High Court was wrong in interpreting the clause (b) of the policy to mean that the liability of the insurance company would arise only under circumstances in which the person driving the van was in employment of the firm. According to the Hon’ble Supreme Court, the High Court overlooked the second part of the clause which stated “with his permission”. The Hon’ble Supreme Court divided persons under clause b, under three heads: (i) any other person – insured himself was driving or (ii) person in employment and is driving on his order or (iii) person driving with the insured’s permission. The Hon’ble Supreme Court stated that the words “with his permission” do not qualify “is in the insured’s employment.” Therefore the clause can be properly read as “any other person with the insured’s permission.” The Hon’ble Supreme Court gave this interpretation to clause b to cover cases in which the mishap happens by a person who is a friend of the insured and is driving with his permission. The insurance company could very well escape its liability by sticking to the interpretation of clause (b) as given by the High Court and the insurance company having collected premium would wriggle out of a loophole. The Hon’ble Supreme Court thus held that clause (b) of the insurance policy is fulfilled. On both the issues the insurance company fails, its liability remains intact and is liable to pay under the comprehensive policy of insurance, both the appeals succeeded but were partly modified. The insurance company was directed to pay the sum/award with 12% interest from the date of accident till payment and the payment shall be made within a period of two months from the date of judgment. The Contract of insurance of a
motor vehicle is a Contract of Indemnity as per section- 124\textsuperscript{85} of the Indian Contract Act, 1872. The insurance company in the given case is the promisor who has promised to save the partnership firm (promisee) from loss caused to it by the conduct of the insurer or the conduct of any other person, in the given case the loss is caused by the promisee. It is pertinent to note that any other person here includes promisee also. There is difference between life insurance and Motor Vehicle insurance which covers loss due to accidents. Under the Motor Vehicle insurance if the accident is caused, and any person dies. The person who is injured/ or dies claims from the wrong doer. The wrong doer recovers the amount of compensation from the Insurance Company under the Contract of Indemnity but the Life insurance is not a Contract of Indemnity. The Contract of insurance is generally the Contract of adhesion (standardized Contracts) whereby the terms of the Contract are set by one of the parties to a Contract and other party has an option either to take it or leave it. The Hon’ble Supreme Court by way of judicial interpretation has tried to decide in favour of the insured, so that the insurance company by taking premium also, is not able to escape from their liability on some technical grounds. This case is an example where the Hon’ble Supreme Court has interpreted the clause of the policy in such a way that the insured is benefitted. According to the researcher the Hon’ble Supreme Court has beautifully interpreted the clause by stating that clauses are disjointed by a disjunctives “or”. The researcher is in agreement with the interpretation given by the Hon’ble Supreme Court in the given case. The bone of contention revolves around the loss caused by “any other person”. The insurance policy leaves the determination of “any other person” to clause (b) of the policy. The Hon’ble Supreme Court has not agreed to the decision of the Tribunal and the High Court which had interpreted the clause to mean “any other person” as one who is insured’s employ and holds a license. The Hon’ble Supreme Court had interpreted it to mean “any other person” either insured’s employ and is driving on his order and holds a license to drive or one who drives with the insured’s permission and holds a license to drive. Therefore, according to the researcher the Hon’ble Supreme Court\textsuperscript{86} was right in holding that there is no breach of the terms of the policy. The partner (by the implied authority) was deemed to have been driving under the implied consent of

\textsuperscript{85} Supra note 64.
\textsuperscript{86} In the words of Hon’ble Supreme Court, “Insurance Company failed to prove that there was a breach of the term of the Contract of insurance as evidenced by the policy of insurance on the ground that the driver who was driving the vehicle at the relevant time did not have a valid driving license. Once the insurance company failed to prove that aspect, its liability under the Contract of insurance remains intact and unhampere and it was bound to satisfy the award under the comprehensive policy of insurance”
the insured and was therefore covered under clause (b) of the policy. Hence the insurance company was held liable to pay compensation to the injured and the heirs of the deceased.

3.5.9 A Transaction between a Banker and Beneficiary – Principle Extended to Letter of Indemnity

In Centax (India) Ltd. v. Vinmar Impex Inc. And Ors case, M/s Vinmar Impex Inc., Singapore (Respondent 1), (seller) entered into a Contract of sale/supply of 100 M.T. of High Density Polythene Powder called HOPE @ $565 per M.T. to Centax (India) Ltd., Calcutta (Appellant), (buyer). An irrevocable letter of credit was opened by the buyer through Allahabad Bank in favour of the seller of $56,500 valid up to June 30, 1985. As per the letter of intent dated April 29, 1985 signed by both the parties, Bills of lading should mention shipping mark 5202. The four containers, containing 100 M.T. HOPE Granules arrived at the Calcutta port on June 5, 1985 in the vessel “Ganges Pioneer”. Each container was covered with four bills of lading.

The original bills of lading etc. were not forwarded by the seller through its bank to the buyer to enable the buyer to take delivery. The Shipping Company was refusing the buyer to take delivery of the cargo for the want of original bills. Correspondence ensued between the seller and the buyer. The seller instructed the buyer to get the release of the cargo from the shipping company upon the buyer furnishing Bank Guarantee through its bank for the release of goods in lieu of the original bills of lading and other documents. Accordingly the Allahabad Bank executed four Letter of Indemnity (described as Letter of Guarantee or Letter of Indemnity or both) and each of the documents was countersigned by the buyer in favour of the Shipping Company. On the basis of the Letter of Indemnity the Shipping Company delivered the goods to the buyers, without the production of original bills of lading or other documents. The buyer sold the goods for Rs.17,50,000. The Shipping Company made a demand to the Allahabad Bank to make the payment under the Letter of Indemnity, and the bank in turn called upon the buyers to make the payment to them. When called upon to make the payment, the buyers moved the Calcutta High Court (Original Side) and brought a suit against the sellers for recovery of Rs.9,25,020.90 p as damages from the sellers, on the grounds that the goods sent were of inferior quality i.e. not of grade 5202 but of grade 5502 and that the sellers did not provide the original

AIR 1986 SC 1924
bills of lading and documents. The buyers applied for the grant of temporary injunction a) for restraining their bankers, Allahabad Bank from making payment to the Shipping Company on the basis of the Letter of Indemnity; b) also restraining the sellers from recovering the amount due there under, from the Allahabad Bank.

The learned Single Judge, High Court disallowed the grant of temporary injunction, by his order dated 25.11.1985, on the ground that the requirements of the Order XXXIX, Rule 1 has not been fulfilled. The learned Single Judge, High Court said there was no prima facie case. The figure 5202 or 5502 has nothing to do with the quality of the goods; it was just a “shipping mark”, as per the letter of intent. Despite different shipping marks, the buyers took delivery of the goods and sold the same for Rs.17,50,000. The buyer appropriated the proceeds of the sale. The buyer alleged a loss/damage of Rs.9,25,020.80p. According to the learned Single Judge, even if there was a loss, there existed a clear margin of around Rs.8 lakhs. The price which the buyer was to pay to the seller was Rs.6,90,000. The learned Single Judge was of the view that there was no reason why the payment should not be made to the sellers, when the goods in question were accepted, sold and the proceeds of the sale were duly appropriated. The court further said that there was no balance of convenience in the favour of the buyer and no irreparable loss would have caused to the buyer if the injunction was not granted. The buyer moved to the division bench of the High Court by way of appeal, the Division Bench of the High Court, vide its judgment dated February 3, 1986 upheld the order of the learned Single Judge. The division bench while deciding the matter also referred to the decision of the United Commercial Bank v. Bank of India88 decided by the Hon’ble Supreme Court of India (supra discussed) and stated that the obligation of the Allahabad Bank to pay the Shipping Company was absolute in terms of the Letter of Indemnity, irrespective of the fact that there arose a dispute between the seller and buyer with reference to the to the performance of Contract. The division bench stated that, there was an unconditional obligation on the part of the Allahabad Bank to pay the Shipping Company, under the Letter of Indemnity. It was on the strength of the Letter of Indemnity that the Shipping Company delivered goods to the buyer, which was sold by the buyer, and the sale proceeds were appropriated by them but nothing was paid to the sellers. Under such circumstances, it was not right on the part of the buyer to institute a suit alleging that

88 Supra note 73.
the goods were of inferior quality. The High Court held that there was no prima facie case. The balance of convenience lied in allowing the banking transaction to go forward and not allowing injunction and no irreparable loss would have caused to the buyer if the injunction was not granted. The buyer moved in appeal to the Hon’ble Supreme Court by way of special leave.

The Hon’ble Supreme Court, considering the decision of the United Commercial Bank v. Union of India, held that upon demand being made by the beneficiary, the bank becomes liable to honour the demand in terms of the Letter of Indemnity or Guarantee, regardless of any controversy between the parties. The court also stated that in the United Commercial Bank’s case the question was with reference to the granting of injunction, in a transaction between the banker and the banker, at the instance of the beneficiary of an irrevocable letter of credit restraining the issuing bank from recalling the amount paid under reserve from the negotiating bank, acting on behalf of the beneficiary against a document of Guarantee/Indemnity at the instance of the beneficiary? The Hon’ble Supreme Court in that case held that the court except in exceptional circumstances, as a matter of rule should not interfere with the interlocutory orders passed and in cases where by there is an irrevocable letter of credit, it implies an absolute bargain between the banker and vendor, to pay and the court in such matters is not free to exercise its discretion and grant injunction.

The Hon’ble Supreme Court in United Commercial Bank case said that the same considerations apply to the Bank Guarantee, a Bank Guarantee is very much like a letter of credit. Accordingly, the Hon’ble Supreme Court\(^89\) in the present case, said that they do not find

\(^89\) “Hamzeh Malas v. British Imex Industries Ltd. (1958) 2 QB 127 Jenkins. LJ stating at p. 12 that:
...the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods which imposes on the banker an absolute obligation to pay...and that 'this was not a case in which the Court ought to exercise its discretion and grant the injunction. The Court held that the same considerations should apply to a Bank Guarantee, and added: A letter of credit sometimes resembles and is analogous to a Contract of Guarantee.
In Elian v. Matsas (1966) 2 LR 495, Lord Denning, MR, while refusing to grant an injunction stated:
...a Bank Guarantee is very much like a letter of credit. The courts will do their utmost to enforce it according to its terms. They will not, in the ordinary course of things, interfere by way of injunction to prevent its due implementation. It was observed that commitments of banks must be allowed to be honoured free from interference by the courts. Otherwise, trust in international commerce would be irreparably damaged.
The Court referred to, with approval, the following observations of Kerr, J. in Section 4D. Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd. It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the lifeblood of international commerce. And added, except possibly in clear cases of fraud of which the banks have notice,
any reason, why the same principles should not be made applicable in case of banker’s Letter of Indemnity. The appeal therefore stood dismissed with costs.

The principle that the injunction cannot be granted by the courts in transactions between the banker and the beneficiary, for stopping payment, was made applicable to the Letter of Indemnity indirectly, under the United Commercial Case. The Hon’ble Supreme Court, made the principle directly applicable to the Letter of Indemnity in the present case. The Hon’ble Supreme Court in the present case stated that the Hon’ble Supreme Court finds no reason why the principles applicable to the Letter of Guarantee should not to stretch to be made applicable to the Letter of Indemnity. During the analysis of the present case, the researcher finds some glitches in the facts. The facts are not clear on the point, why Shipping Company made a demand upon the Allahabad Bank to honour the Letter of Indemnity. The courts have not gone into the question, why demand was made? The courts went forward to decide whether an interim injunction could be granted on the demand made from the Allahabad Bank for payment of money for damages or not?

In both the cases (United Commercial Bank; Centa India) the Letter of Indemnity/Guarantee was executed. In the former case the letter was executed by the bankers of the sellers in favour of the bankers of the buyer. In the present case, the letter was executed by the bankers of the buyer in favour of the Shipping Company on instruction from the seller. The researcher finds it difficult to understand as to why the Indemnity letter was executed by the buyer’s banker. According to the researcher the Letter of Indemnity should have been executed by the bankers of the sellers, because it was the sellers who failed to provide the original bill of lading and other documents through their bankers to the buyer. Anyhow, the Letter of Indemnity was executed by the buyer’s banker in favour of the shipping company for delivering the goods to the buyer without any original bill of lading or other documents. The Hon’ble Supreme Court in United Commercial bank stated that the courts as a matter of rule refrain from granting injunction to restrain the performance of the Contractual obligation arising out of the letter of credit or a Bank Guarantee between one bank and another. In United Commercial bank case, the Letter of Indemnity was executed for and by the parties in question through their bankers. In the present

the courts will leave the merchants to settle their disputes under the Contracts by litigation or arbitration as available to them or stipulated in the Contracts.” Referred and relied.
case the Letter of Indemnity was executed by the banker of the buyer, countersigned by the bankers in favour of the third party i.e. the Shipping Company. As was stated in the United Commercial Case, the bank knows only the letter of credit. Similarly, the bank knows only the Letter of Indemnity. The bank is not supposed to go in the terms of the contract of sale to get the letter of credit or the Letter of Indemnity/ Guarantee executed. In the United Commercial Bank case, the payment of made under reserve as there was discrepancy with respect to the description of the oil mentioned in the letter of credit and the railway receipts. In the present case, though the discrepancy with respect to the shipping mark of 5502 instead of 5202 was alleged for claiming injunction but the point at which it was alleged was at a very late stage, the buyers had taken the delivery of the goods, sold them and appropriated the proceeds. Further the discrepancy was with respect to the letter of intent and not letter of credit. Therefore, the plea of inferior goods was unsustainable. The researcher is of the view that the Hon’ble Supreme Court had tried to extend the principle laid down in the United Commercial Bank case to Letter of Indemnity\textsuperscript{90} and/or to third parties in the present case (Centax India Ltd.). Further an injunction to restrain the seller from recovering the amount due was also moved by the buyer on the ground of inferiority of the goods, as the goods were of grade 5502 instead of 5202 and that the seller failed to forward the original bills of lading and other documents through its bankers to the buyer, was also denied. The point put forward by the researcher in this aspect is that the buyers were free not to accept the goods at the time of delivery by the Shipping Company, since the shipping mark of the goods was different to the one stated in the letter of intent. But the buyers accepted the goods. The bank therefore, could not be restrained from making payment to the seller, more so as this discrepancy had nothing to do with the content of the letter of credit. Once the accompanying documents adhered to the details mentioned in the letter of credit, the obligation of the buyer’s banker to make the payment was absolute, irrespective of difference between the buyer and seller with respect to the terms of the Contract or its quality or the performance of the Contract. The case relates to Section 125 of the Indian Contract Act, 1872 and deals with the rights of the Indemnity-holder when sued. In the present case, the Shipping Company is the Indemnity holder who has under the Letter of Indemnity executed by the Allahabad Bank in their favour have undertaken to Indemnity for the Shipping Company of the loss/ damages arising due to the

\textsuperscript{90} In the words of Hon’ble Supreme Court, “We do not see why the same principles should not apply to a banker's letter of Indemnity.”
delivery of the goods to the buyers without original bills of lading and/or other documents. S-125 of the Indian Contract Act is limited in application as it related to only those rights of the Indemnity-holder which comes into play only when sued. Unless the Indemnity holder is sued, section 125 would not come into play. Looking into the limitation of Section 125 of the Indian Contract Act, even the Law Commission of India, in its Thirteenth Report, 1958 recommended the addition of the Section 125A, stating the Rights of the Indemnity-holder. It states the right of the Indemnity holder (promisee) to institute a suit against the promisor irrespective of whether any actual loss has been sustained by the promisee or not. It also says that where the liability has arisen against the promisee in favour of the third party, the promisee in such case can obtain a decree against the promisor compelling him to either set apart a fund from which the promisee could meet his liability or direct the promisor to discharge such liability itself.

3.5.10 Conditional Contract under the Letter Of Credit Must Be Honoured

In State Bank of India & Ors. v. Manganese Ore (India) Ltd. & anr case,\(^91\) the first respondent Manganese Ore (India) Ltd. &Anr (seller) entered in to a contract of sale with M/s Emmenor Export traders (buyer). A letter of credit was executed by M/s Emmenor Export traders (buyer) through its banker State Bank of India in favour of Manganese Ore (India) Ltd. A conditional contract, under the letter of credit, was entered between the SBI Bank (banker of the buyer) and M/s Emmenor Export (buyer). As per the clauses\(^92\) of the conditional contract, the goods so shipped by the seller, should have the Manganese content not below 39 per cent. Phosphorous maximum 0.23 per cent. Some other percentages with respect to other elements were also specified.

\(^91\) AIR 1997 SC 254

\(^92\) "Clauses 1 (i) and 1 (iii)(b). Clause 1(i) provides in respect of the documents for negotiations. Firstly, it is the seller’s signed commercial invoice in quadruplicate based on the weight, sampling, analysis and moisture determined at the time of shipment, valuing the ore at the ratio of 17 U.S. dollars converted into @ Rs.4.75 to one U.S. dollar per dry metric Tonne of 1,000/Kg. net dry weight, F.O.B. Vishakhapatnam, on the basis of 40 per cent Manganese with the pro rata scale for each unit of Manganese content above or below 40 per cent down to the minimum of 39 per cent. The Clause 1(ii)(b) speaks about the certificate in triplicate from M/s, R.G. Briggs and Co. Private Ltd. of sampling assaying and moisture, determined at the port of shipment showing the material to conform to the following Contracted qualities. (B) hard lumpy. Indian Low grade Manganese Ore having the following chemical analysis at 105 degrees C. minimum 39 per cent (F.E.): Iron Maximum 8.25 per cent; SIO-2 Maximum 23.00 per cent; Phosphorus minimum 0.23 per cent (All approximately)."
The documents were presented by the seller to the banker of the buyer for payment of the shipment at the time of negotiations dated 20.06.1966. The bankers of the buyer refused payment on the grounds that the conditions of the “conditional contract” were not fulfilled. The goods supplied were not as per the quality contracted for under the letter of credit, phosphorus was more than agreed maximum of 0.23 (actually 0.246) and Manganese was below the minimum of 39 per cent (actually 38.06). The suit was brought by the seller in the trial court against the buyer and State Bank of India for the recovery of the suit amount Rs.1,69,000/-. The trial court looked in the clauses of the conditional contract and found the use of the word “all approximately” after the mentioning of the percentages of the elements under the conditional contract. The trial court stated that the maximum and/or minimum limits mentioned under the conditional contract and/or attached sheet in the letter of credit should be taken to mean as rejection limits and therefore no approximation can be allowed in the maximum/minimum limits. If approximation is allowed to the rejection limits, there will be no limit in lowering down the minimum and shooting up the maximum. According to the trial court, the goods failed to conform to the terms and conditions of the letter of credit in respect of quality of the goods, it did not grant the decree against the State Bank of India. The seller shall seek payment from the buyer and not the banker of the buyer.

The seller filed an appeal to the division bench, High Court. The High Court stated that since all the documents have been submitted by the seller to the banker of the buyer, the banker was under and absolute obligation to pay, it further said that the maximum/minimum limits were open to the approximation and since the quality of the goods was in approximate to the conformity of goods. The SBI (banker of the buyer) is not absolved from his liability to pay. The High Court accordingly reverted the decree of the trial court and made the bank (SBI) liable to pay to the sellers.

The bank (SBI) filed appeal to the Hon’ble Supreme Court by way of a Special leave petition against the decision of the Division Bench of the Bombay High Court made on 30-

93 “…..The minimum and the maximum percentages shall have to be treated as the percentages of rejection limits. The approximate percentage can be slightly above the minimum agreed and slightly below the maximum agreed. This clause regarding approximation cannot be read so as to allow a percentage below the rejection limits. If this is allowed there will be no limit in lowering down the minimum and the shooting up the maximum. In my opinion the minimum and maximum percentage stated in the agreement at exhibit 68 or in the attached sheet of letter of credit at exhibit 78, shall have to be taken as rejection limits.”
The legal issue which emerged was; whether the appellant (SBI) has been absolved of its liability to honour the Contract entered into with the buyer (defendant 1)?

The Hon’ble Supreme Court, disagreeing to the decision of the division bench of the High Court, stated that there is a difference between an irrevocable and unconditional letter of credit on one hand and revocable and conditional letter of credit on the other hand. According to the Hon’ble Supreme Court, in the present case the letter of credit was not irrevocable and unconditional. Under the letter of credit, a conditional contract was entered into between the buyers and the bankers of the buyers (SBI Bank/ Appellant). Therefore, by virtue of the conditional contract under the letter of credit, the bank was bound to see that the specifications and/or conditions mentioned in the letter of credit and conditional contract have been fulfilled in the documents so submitted to the bank by the sellers. While interpreting the relevant clause of the conditional contract related to the maximum and/or minimum limits of element, the Hon’ble Supreme Court did not agree to the decision of the Division Bench High Court in which by virtue of the last clause namely “approximate”, the Division Bench High Court said that the actual percentages of the elements were open to approximation and that the bank is not absolved from its liability to pay. The Hon’ble Supreme Court stated that this decision of the High Court doesn’t appear to be correct. The parties had admitted that the goods were not as per specification and the standard required under the letter of credit. The letter of credit being conditional and its conditions not being adhered to, the bank (appellant) was absolved of its liability to pay the seller. Therefore the view of the trial court was correct. The view of the High Court is incorrect and the order of the High Court is accordingly set aside. The decision of the trial court that the seller should seek for the payment from the buyer is restored. The High Court in its order dated 30-31.10.1979 had made the appellant liable to pay. When the leave was granted by the Hon’ble Supreme Court, the Hon’ble Supreme Court had (as per the order of the HC) directed the bank/SBI to deposit the decretal amount and the seller was given liberty to withdraw the amount on furnishing adequate security to the satisfaction of the Registrar of the High Court. The Hon’ble Supreme Court stated that since at the time of granting of leave this court had directed the appellant/ SBI bank to deposit the amount, and if the sum so deposited is already withdrawn by the seller, the Hon’ble Supreme Court stated that under such circumstances the SBI bank is at the liberty to recover the amount from the security furnished by the sellers. If the security so furnished is not sufficient, it is open to the SBI Bank/ appellant to
recover the balance amount from the seller in accordance of law. The appeal was therefore allowed, without costs.

According to the researcher, the given case is analogous to the United Commercial v. Bank of India\textsuperscript{94} and Centax (India) Ltd. v. Vinmar Impex\textsuperscript{95} cases. The present case and the previously mentioned two cases deal with the letter of credit. Though the observations of the previously mentioned two cases have not been picked up in the present case, but the decision appears to be in consonance with the decisions made in the previously mentioned two cases. In the previously mentioned two cases, Letter of Indemnity/Guarantee was executed. In the United Commercial Bank case, the Letter of Indemnity/Guarantee was executed by the seller in favour of the banker of the buyer and in Centax case the Letter of Indemnity/Guarantee was executed by the banker of the buyer in favour of the Shipping Company. In the present case under the letter of credit a conditional contract was made between the buyer and the banker of the buyer and the Hon’ble Supreme Court differentiated between the irrevocable and unconditional letter of credit on one hand and revocable and conditional letter of credit on the other. According to the Hon’ble Supreme Court, in the present case the letter of credit was not irrevocable and unconditional. Under the letter of credit, there was a conditional contract under which the banker of the buyer was bound and the banker was only under an obligation to pay, when the conditions laid down in the letter of credit and the conditional contract were adhered to. The Hon’ble Supreme Court in the previously mentioned two cases has stated that once the conditions laid down in the letter of credit were fulfilled, the obligation of the banker to pay is absolute irrespective of the fact that there arose any difference between the performance of the Contract or quality of goods. The banker has only to see the description mentioned in the documents submitted by the seller. In the present case, we find an extension of the principle laid down in the United Commercial Bank Case and Centax Case. According to the researcher, the Hon’ble Supreme Court, had tried to say that the Letter of Indemnity/Guarantee are independent Contracts and the bank is bound to pay, if the conditions of the Letter of Indemnity/Guarantee are adhered to. In the present case, the difference lies in the fact that the conditional contract is entered into under the letter of credit. Thereby the banker is under an obligation to adhere to the conditions mentioned in the letter of credit and the conditional contract, even if it relates to the quality of goods. Once the conditions

\textsuperscript{94} Supra note 88.
\textsuperscript{95} Supra note 87.
are fulfilled, both under the letter of credit and the conditional contracts, the liability of the banker to pay becomes absolute. But if the conditions are not fulfilled, the banker is not entitled to pay. Another point of similarity which one finds between Centax Case and present case is that the court has instructed the buyer to pay to the seller in both cases. In the present case also the Court instructed the buyer to pay to the sellers, though the bankers of the buyers were under no obligation to pay as the conditions of the letter of credit and conditional contract were not fulfilled. The area which is not clear to the researcher in the present case is why the Hon’ble Supreme Court directed the buyers to make the payment to the sellers, as the facts of the case were silent on the facts as to what happened to the goods, whether they were accepted etc. In the given three cases, we find gradual expansion of the principles by the Hon’ble Supreme Court as laid down in the United Commercial Bank to Centax Case to SBI Cases. In the United Commercial bank case, the principle had implicit application to the Letter of Indemnity, which was made explicit to the Letter of Indemnity in the Centax Case. Further in the SBI case (present case) the principles which were restricted to letter of credit were extended to include a conditional contract made under the letter of credit. It can be inferred from the above mentioned three cases, that the letter of credit is analogous to the Letter of Indemnity and/or letter of credit.

### 3.5.11 Bank Guarantee is a Contract of Indemnity and Not a Contract of Guarantee

In State Bank of India & Anr. v. Mula Sahakari Sakhar Karkhana Ltd. case, Mula Sahakari Sakhar Karkhana (Respondent) entered into a Contract for the installation of paper plant with M/s Pentagon Engineering Pvt. Ltd. (Pentagon). The Respondent was a Cooperative society which had a sugar factory. The Contract value was Rs.3,40,00,000/-. A Performance Guarantee with regard to the machinery supplied was furnished by Pentagon. There was a clause in the Contract which dealt with retention of 10% of the total Contract value by the Cooperative society, under which 5% of the Contract price shall be payable after satisfactory commissioning and working of the plant for three months; and 5% of the Contract price shall be payable after satisfactory commissioning and working of the plant for six months.

Pentagon by its letter dated 06.04.1985 suggested for the waiver of the cooperative’s right to retain 10% of the Contract price and proposed in its place, for a letter of credit so that the

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96 AIR 2007 SC 2361
Pentagon could furnish appropriate Bank Guarantee for 10% of the total Contract value. The Cooperative accepted\footnote{The cooperative society accepted stating: "You have also to submit the Performance Guarantee at 10% of the Contract price, if the same Guarantee is not received the karkhana is entitled to recover it from the balance payment and accordingly we have deducted it for want of Performance Guarantee."} the proposal of the Pentagon, but also asked for the “Performance Guarantee” for 10% of the Contract price from the Pentagon, failing which the Karkhana would be entitled to recover the said amount from the balance amount and accordingly deduct it for the want of Performance Guarantee. Pentagon agreed to the condition of the cooperative and in response to it asked for the opening of a separate letter of credit for 10% retention by the Cooperative through its letter dated 16.04.1985 and also stated in the letter that Pentagon would give the Bank Guarantee to the cooperative within 10 to 15 days as soon as the letter of credit is opened by the cooperative. Accordingly the Bank Guarantee/ Indemnity was duly furnished by the State Bank of India on or about 07.09.1985, which covered 10% retention amount of Rs.34 lakhs. A request for the release of Rs.13,76,285/- against the Proforma invoices of the material reached at site was also made, on the receipt of the Guarantee. It also stated that the Bank Guarantee was issued in pursuance of the agreement dated 25.09.1983. The Bank Guarantee dated 04.09.1985 was issued by the State Bank of India. Due to differences between the cooperative and pentagon, the Contract of pentagon was terminated by the cooperative vide notice dated 17.07.1987. A claim of Rs.3,23,28,209.10 was made by the cooperative from the Pentagon. The Pentagon denied it and also asserted that an amount of Rs.4,66,73,300/- (more than the Contract value) was due to the Pentagon by a letter dated 18.07.1987. Thereafter, the respondent invoked the Bank Guarantee and claimed amount under the Bank Guarantee, from the Bank. The State Bank of India resisted it on the ground that the bank had actually executed an agreement of Indemnity under which the cooperative was entitled only in case of losses, claims, damages, actions and costs which might have been suffered by the cooperative. Since in the present case no loss has occurred, State Bank of India is not entitled for any payment.

The Cooperative moved to the Court of Civil Judge, Sr. Division, Ahmednagar and filed a suit together with an application for the deposit of Rs.34,00,000/- by the bank (State Bank of India). The trial court decreed in favour of the Bank and the matter went up to the High Court for the passing of an interim order. The High Court by its order dated 23.02.1988 directed the bank to retain the sum and in case the suit is decreed, the bank would pay the amount to the
respondent with the interest of 12% per annum. The suit was dismissed. The Cooperative moved in appeal against the order to the High Court. The High Court decreeing the suit directed the Bank to pay the said sum of Rs.34,00,000/- with interest @ 14% per annum. The High Court construed the agreement dated 25.09.1983 as Bank Guarantee. The State Bank of India moved to the Hon’ble Supreme Court against the decision of the High Court. The main legal issue which was raised before the Hon’ble Supreme Court was; whether the Bank Guarantee was a Contract of Indemnity or a Contract of Guarantee?

It was contented by the appellant (State Bank of India) that the document dated 04.09.1985 is a Contract of Indemnity and not a Contract of Guarantee and that the High Court has erred in construing the said document as the Contract of Guarantee instead of the Contract of Indemnity. It was further contended that the granting of an interest of 14% is against and inconsistent to the order of the High Court dated 23.02.1988.

On the other hand, it was contended by the Cooperative that the substance of the matter must be taken into consideration in the backdrop of events in which the Bank Guarantee was furnished. It referred to the original agreement which stipulated final payment on the furnishing of Bank Guarantee. Even the Pentagon which was the client of the Bank had approached the Bank for the furnishing of Bank Guarantee. The operative portion of the Bank Guarantee was referred to, together with the other terms and conditions, under which it was contended that the High Court has erred in stating that the agreement was the Contract of Guarantee. It was further contended that High Court erred in opining that according to the recitals in the preamble the document in question, was the Contract of Guarantee.

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98 The Operative portion of the Bank Guarantee dated 7th September, 1985 reads, thus:

"NOW THEREFORE THIS BANK GUARANTEE is made in favour of Mula Sahakari Sakhar Karkhana Ltd. by State Bank of India (Dombivli Industrial Estate Branch) agreed security the State Bank of India (Dombivli Industrial Estate Branch) hereby agrees and undertake subject to the terms and conditions set forth in this agreement to indemnify and keep indemnified Mula Sakhari 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."

In addition to the aforementioned, the Appellant agreed to the other terms and conditions referred to therein, stating:

"NOTWITHSTANDING anything hereinbefore contained, our maximum liability under this Guarantee is restricted to Rs.34,00,000/- (Rupees Thirty four Lacs only). This Guarantee shall remain in force upto 3rd September 1987 unless a suit or action to enforce claim under this Guarantee is filed against us on or before the 3rd September, 1987 all right under this Guarantee shall be forfeited and we shall be relieved and discharged from all liabilities hereunder."
According to the Hon’ble Supreme Court, the High Court inserted some words in the documents which were not there viz. “unequivocal condition”, and further said that the terms and conditions of the Bank Guarantee are unconditional and absolute, and that the respondents had no choice but to honor the same. Such terms, were not used in the said document and therefore the construction of the High Court was patently wrong. It further erred in taking the operative portion of the document as preamble. The High Court also relied on the oral evidence of the witnesses holding that the document was the Bank Guarantee.

The Hon’ble Supreme Court going through the contentions laid down by both the parties, stated that a document must be construed primarily on the basis of its terms and conditions contained therein, the question of looking into the surrounding circumstances arise only in case of ambiguity. Furthermore, the court shall not supply any word by itself in order to construe to document in question. In the present case the document in question is a commercial document. According to the Hon’ble Supreme Court, the document in question was the document of Indemnity as it undertook to indemnify the Cooperative Society against “all losses, claims, damages, actions and costs which may be suffered by it”. Further the Hon’ble Supreme Court clearly stated that the supply of words viz. “unequivocal condition”, “the cooperative society would be entitled to claim the damages without any delay or demur” or the Guarantee was “unconditional and absolute” by the High Court were not found in the Bank Guarantee furnished by the bank. Therefore the High Court grossly erred in stating that the document in question was the Contract of Guarantee and not the Contract of Indemnity. The court found all the correspondence and clauses contended by the counsel of the cooperative society in favour of the cooperative society but stated that construing of Bank Guarantee in light of other documents is not right. The Hon’ble Supreme Court also stated that there is nothing wrong in construing a document in the light of other documents provided the document is contained in more than one document and such a document must be a subject matter of Contract by and between the parties. The Hon’ble Supreme Court was of the view that in the present case the correspondences exchanged did not form part of the same transaction. The Hon’ble Supreme Court didn’t agree to any of the case on which the counsel of the Cooperative Society had placed reliance. The High Court on knowing that Section 92 of the Evidence Act would be attracted in the present case, it

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99 Section 92 of the Indian Evidence Act, 1872, S. 92. Exclusion of evidence of oral agreement - When the terms of any such Contract, grant or other disposition of property, or any matter required by law to be
went on to referring the oral evidence, which according to the Hon’ble Supreme Court was wrong.

The Hon’ble Supreme Court while going through the contentions, terms of the documents, arrived at a conclusion that the document in question was the Contract of Indemnity and the High Court has thus misread and misinterpreted the document. Court further said that “it is beyond cavil that a Bank Guarantee must be construed on its own terms. It is considered to be a separate transaction”. Neither did the Bank Guarantee document refer to any clause of the Contract nor did any clause of the Contract require Pentagon to furnish any Bank Guarantee. The Hon’ble Supreme Court referred to various cases and came to the conclusion that the document in question was not an absolute or unconditional Bank Guarantee but it was a Contract of Indemnity.

According to the researcher the case in question demands analysis of Section 124 of the Indian Contract Act, 1872, which defines the Contract of Indemnity. As per definition, Contract of Indemnity is a Contract by which one party promises to save the other from loss caused to him by the promisor himself or by the conduct of any other person. The consideration aspect in the Contract of Indemnity is the “loss”. Cases have already been dealt with in which we had come to the conclusion that it is not the accruing of the actual loss which is important rather it is the point of the time when the liability becomes absolute, which is relevant. In the present case an attempt is made by the Hon’ble Supreme Court to state that one cannot construe or interpret a document reduced to the form of a document, have been proved according to the last section, no evidence of any oral agreement or statement shall be admitted, as between the parties to any such instrument or their representatives in interest, for the purpose of contradicting, varying, adding to, or subtracting from, its terms: Proviso (1) Any fact may be proved which would invalidate any document, or which would entitle any person to any decree or order relating thereto; such as fraud, intimidation, illegality, want of due execution, want of capacity in any Contracting party, want or failure of consideration, or mistake in fact or law. Proviso (2) The existence of any separate oral agreement as to any matter on which a document is silent, and which is not inconsistent with its terms, may be proved. In considering whether or not this proviso applies, the Court shall have regard to the degree of formality of the document. Proviso (3) The existence of any separate oral agreement, constituting a condition precedent to the attaching of any obligation under any such Contract, grant or disposition of property, may be proved. Proviso (4) The existence of any distinct subsequent oral agreement to rescind or modify any such Contract, grant or disposition of property, may be proved, except in cases in which such Contract, grant or disposition of property is by law required to be in writing, or has been registered according to the law in force for the time being as to the registration of documents. Proviso (5) Any usage or custom by which incidents not expressly mentioned in any Contract are usually annexed to Contracts of that description, may be proved: Provided that the annexing of such incident would not be repugnant to, or inconsistent with, the express terms of the Contract. Proviso (6) Any fact may be proved which shows in what manner the language of a document is related to existing facts.
by merely looking at the name by which the document is called. The name given to a document can be a misnomer in the true sense of the term. The present case has revolved around a Bank Guarantee, given by the Bank (State Bank of India) at the instance of the Pentagon (supplier). As per the terms of the Bank Guarantee, the bank had undertaken to indemnify the Respondent in case of loss to the tune of 34 lakhs. It is important here to understand the difference between the Contract of Indemnity and Contract of Guarantee. In case of the Contract of Indemnity, there are two parties in which one, the indemnifier undertakes to cover up the loss of the indemnified, provided the loss is either caused due to the promisor himself or any other person. The essentials of the Contract of Indemnity are duly met in the present case. In case of Contract of Guarantee, there are three parties, the principal debtor, the creditor and the surety. The essence of the Contract of Guarantee is that there is a pre-existing debt. And existence of pre-existing debt is not the case in the present situation. It may sometime happen that there may exist three parties on the face of the transactions but it is not necessary that merely by the existence of three parties the transaction would amount to be a Contract of Guarantee. Even if three parties are involved the transaction may still be the Contract of Indemnity and not the Contract of Guarantee. In the present case there were three parties, the bank (appellant); the Respondent; and Pentagon. The “Bank Guarantee” was executed by the bank at the instance of the Pentagon in favour of the respondent. The researcher is of the view that it does appear that the “Bank Guarantee” in question is a Contract of Indemnity but it is humbly submitted that the Hon’ble Supreme Court has not explained the reasons based on which the court has come to such conclusion. In its judgment the Hon’ble Supreme Court has only stated that the High Court has erred in its decision to state that the “Bank Guarantee” was a Contract of Guarantee. How the Hon’ble Supreme Court has arrived at such conclusion is not very clear. Though the researcher is in agreement, to state that the name “Bank Guarantee” was a misnomer and it is a Contract of Indemnity. In the present case, it was held that since no loss is caused to the Respondent, the appellant was not entitled to pay any sum to the respondent. Nothing has been discussed by the Hon’ble Supreme Court about the loss in question. Further in case of Contract of Guarantee, there is an assurance by the surety to pay the creditor in case there is a default in payment by the principal debtor. In the present case there was nothing as surety, who made an assurance to pay in case of default. The only reason on which the Hon’ble Supreme Court stated “Bank Guarantee” as the Contract of Indemnity was that as per the “Bank Guarantee” the appellant bank had undertaken to cover
up the loss which might accrue to the respondent. Relying on the “operative part of the Bank Guarantee”, the Hon’ble Supreme Court said that since the “Bank Guarantee” is a promise to cover up the loss of the respondent by the bank it is very much a Contract of Indemnity under Section 124\(^\text{100}\) of the Indian Contract Act, 1872. The Bank Guarantee in the present case, was in pursuance of the agreement dated 25.09.1983, was in favour of the Cooperative and was executed at the instance of the Pentagon. Neither the document in question specifically referred to any particular clause of the Contract nor did any clause of the Contract require Pentagon to furnish any Bank Guarantee. Therefore the Bank Guarantee constituted a separate, distinct, independent Contract between the bank and the respondents. The Bank Guarantee is a commercial document which must be construed according to its terms and conditions and not as per the surrounding circumstances. The question of referring to surrounding circumstances arises only in case of ambiguity in the document, where there is no ambiguity in the document, referring to the surrounding circumstances would not be right in law. In the present case also there appeared no ambiguity in the document therefore the High Court erred in referring to the surrounding circumstances and stating that Bank Guarantee was the Contract of Guarantee. The researcher is in agreement with the decision of the Hon’ble Supreme Court, and this case forms one of the important decisions related to the Contract of Indemnity. In the cases of Indemnity studied so far, including the present case, one thing is clear that in the Contract of Indemnity, the aspect of consideration is “loss” and its very nature is both future and fluctuating. The concept of Indemnity is very dynamic and forms one of the essentials in the Contracts of the commercial world, today. The question of covering up loss is objective and uncertain. The loss may never occur, but the Indemnity clause or Indemnity Contract is an assurance to the covering of the loss, if it occurs. Business or commercial transactions have an inbuilt risk factor in them. Such clauses or Contracts help in providing greater credibility in the business. Indemnity is fundamental today as no one wishes to suffer loss. But losses are inevitable; anyone who assures to cover up the loss of business is always preferred. How much and when the amount is to be paid is a subjective consideration for which one cannot be sure beforehand. In the present case, the cooperative was unable to prove “any loss or damage for design, performance, workmanship or supply of any defective material” therefore the bank under the Contract of Indemnity was not liable to pay to the cooperative.

\(^{100}\) Supra note 85.
3.5.12 Loss Caused By Change in Law – No Indemnity under Indian Contract Act, 1872

In M/s Sumitomo Heavy Industries Limited v. Oil & Natural Gas Commission of India case, 101 as per the facts of the case, the Respondent (Oil & Natural Gas Commission of India) invited tenders on 22.07.1982 for the installation and commissioning of Well-cum-Production Platform Deck and connected system including submarine pipelines on a turn-key basis at its Bombay High (South) Offshore Site for the extraction of Oil. The Appellant (Sumitomo Heavy Industries Limited) applied on the date for closing of the bid (11.10.1982). At this time, any income arising from the work done about 100 miles off the coast was not taxable under the Income Tax Act. The Contract price was J.Y.10,823,237,000/- The Contract was accepted and signed by both the parties on 07.09.1983. After the closing of the bid but before the signing and acceptance of the tender, the GOI (Government of India) issued a notification under which the Income Tax Act, 1961 was extended to the Continental Shelf of India and the Exclusive Economic Zone, hence the work which was initially not taxable became taxable w.e.f 01.04.1983. Clause 44BB was introduced in the Income Tax Act under the Finance Act, 1987 to the same effect w.e.f 01.04.1983.

After the singing of the Contract, the appellant had entered in to Contract on 28.12.1983, with M/s Mc Dermott International Inc (MII) and appointed it as the Sub-Contractor for the execution of the work to the full knowledge of ONGC. Work was completed and a certificate of completion and acceptance was issued by the ONGC in favour of the appellant on 11.04.1984. A Discharge Certificate was also issued by ONGC on 18.05.1984.

It was only in July, 1987 that circular with guidelines for computing tax liability under Clause 44BB of the Income Act, 1961 were issued, instructing the Commissioners of Income Tax to access the tax liability. Accordingly in the year 1988, MII was served income tax notice to re-open and revise the assessments already made for the assessment year 1984-85 and 1985-86. MII were asked to pay tax on the income from the ONGC for the work executed by MII at Bombay High (South) Offshore Site. MII objected to it on the ground that the tax returns for the said years have already been filed and that they had incurred loss, they are therefore not liable to pay any tax. The objections raised by the MII was rejected by the authorities and a tax liability to

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the tune of US$1, 12,447.84 (Rs.1, 85,23,780/-) was imposed by the government on MII. The amount was paid by MII. MII claimed the sum from the appellants, and it was accordingly reimbursed by the appellant to the MII. After reimbursing the same to the MII, the appellant claimed the same from the Respondent under clause 17.3 (Change in law) of the General Conditions of Contract.

A statement of claim was filed by the appellant on 13.1.1992. Two arbitrators were appointed one each by both the parties. The arbitrators so appointed differed in their reasons for conclusion dated 04.07.1994 and 18.07.1994. Therefore the matter was referred to Sir Micheal Kerr (Umpire) to give the award.

After the framing of the issues, the Umpire held that it was “cost” which was both necessary and reasonable and accordingly the respondent ONGC was required to reimburse the same to the appellant. The respondent went in appeal against the award of the arbitrator in the Single Bench of the Bombay High Court. The Single Bench set aside the award dated 27.06.1995 made by the Umpire. The respondent moved in appeal to the Division Bench of the High Court which confirmed the decision of the Single Judge and dismissed the appeal. According to the Division Bench, respondent could not be held liable to the appellant for the income-tax liability of the Sub-Contractor and that the Umpire exceeded its jurisdiction in allowing the appellant’s claim under clause 17.3 of the General Conditions. An appeal was made to the Supreme Court by way of a special leave, against the order of the Division Bench.

Issues (SC): Whether, as held by the Division Bench, the Umpire has failed to apply his mind to the material on record and the clauses of the Contract between the parties thereby rendering a perverse award?

Whether the decision of the Umpire was possible one and the High Court has erred in interfering with the Award?

The Supreme Court held, that the Umpire had meaningfully interpreted the clause 17.3, fully looked into evidence – including pre-contractual negotiations and documents arising therein. It was a fully reasoned award.
According to the Supreme Court, the award was given by the Umpire on the evidence of record and after giving due weightage to the clauses. An award which the Umpire holds to be correct based on his opinion derived from the material and evidence of record, is final and binding. Appeal was allowed by the Supreme Court, decision of the High Court (single and division bench both) was set aside. Award made by the Umpire was upheld.

According to the researcher, most of the contentions by the parties revolved around clause 17.3\textsuperscript{102} of the agreement. The researcher has restricted its analysis to clause 17.3 in the present case which related to clause of Indemnity. The researcher is in agreement with the opinion of the High Court that the clause which is in nature of the Indemnity must be construed narrowly. But at the same time the researcher is at disagreement with the opinion of the High Court where it construes clauses 17.3 as Indemnity under section 124 of the Indian Contract Act, 1872; despite the “loss” caused due to change in law. As per the opinion of the High Court clause 17.3 in the present case is an Indemnity clause, if we assume that opinion of the High Court as correct, then it has to be seen that how far does the term “cost” used in clause 17.3 would be stated as “loss” as per the definition given under section 124 of the Indian Contract Act, 1872. It is also submitted that in construing clause 17.3 it is fundamental to understand whether the term “cost” as used in clause 17.3 is synonymous with the term “loss” as used in the definition of the Contract of Indemnity given under section 124 of the Indian Contract Act, 1872. According to the researcher, the High Court in stating clause 17.3 as Indemnity clause had meant if not directly, that cost is synonymous to loss. According to the researcher, as has already been mentioned in above mentioned previous cases that “loss” signifies an aspect of the consideration in the Contract of Indemnity. For any Contract to come into existence the presence of consideration is mandatory. This case is an example of interpretation of the term “cost” as “loss” under the Contract of Indemnity.

The Hon’ble Supreme Court has not denied that the clause in question (17.3) is a clause of Indemnity but as the same time the Hon’ble Supreme Court has stated that clause 17.3 is not a

\textsuperscript{102} Clause 17.3 makes the provision in the event of a Change in Law. This clause reads as follows: “Should there be, after the date of bid closing a change in any legal provision of the Republic of India or any political sub-division thereof or should there be a change in the interpretation of said legal provision by the Supreme Court of India and/or enforcement of any such legal provision by the Republic of India or any political subdivision thereof which affects economically the position of the Contractor; then the Company shall compensate Contractor for all necessary and reasonable extra cost caused by such a change.”
Contract of Indemnity as covered under section 124 of the Indian Contract Act, 1872 since the “loss” as contemplated in the said section is one which is caused either by the promisor himself or by the conduct of any other person. Since the “loss” is caused by the change of law. The change of law could not be taken as “loss” caused by any person. The moot point here is whether Parliament (legislature who makes law) and President (who executed its) are taken as person in the eyes of law or not. This difference according to the researcher is of paramount importance as it highlights the need to incorporate the suggestions made by the Law Commission of India in its 13th Report, in which the Law Commission has suggested\textsuperscript{103} to widen the scope of the Contract of Indemnity under section- 124 of the Act, to include cases in which “loss” is caused by “event” and not necessarily by persons. According to the researcher the present definition of the Contract of Indemnity as given under section 124 of the Indian Contract is narrow and restricted. Therefore the same must be accordingly amended so as to incorporate changes\textsuperscript{104} as suggested by the Law Commission of India in its 13th report.

According to the researcher, this case has highlighted two fundamental points that the term “loss” as used in section - 124 of the Indian Contract Act, 1872 may be interpreted so as to cover “cost” within the ambit of “loss”. Secondly, it has indirectly addressed to the compelling need of widening the scope of the section - 124 by substituting the said section with its suggested definition of the Contract of Indemnity under section 124 of the Indian Contract Act,1872 as follows:

"A Contract by which one party promises, \textit{expressly or impliedly}, to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other \textit{person or by any event not depending on such conduct}, is called a “Contract of Indemnity”".

The words in italics are additions suggested by the Law Commission to the present definition of the Contract of Indemnity under section 124 of the Indian Contract Act, 1872. According to the researcher, due to the limited scope of the definition under section 124 of the Act, the courts are unable to incorporate clauses of Indemnity under section 124 of the Act. In

\textsuperscript{103} Suggested definition of the Contract of Indemnity, by the Law Commission of India, in its 13\textsuperscript{th} Report, 1958.For section 124 of the Principal Act, the following section shall be substituted, namely: 124. "Contract of Indemnity" defined.

"A Contract by which one party promises, \textit{expressly or impliedly}, to save the other from loss caused to him by the conduct of the promisor himself Or by the conduct of any other \textit{person or by any event not depending on such conduct}, is called a "Contract of Indemnity."

\textsuperscript{104} Ibid.
such cases, the Indemnity clauses are enforced by way of judicial innovations under the Contract and not under Section 124 of the Act.

Appraisal

There are presently two sections in the Indian Contract Act, 1872, Sections-124 and 125; which tend to deal with the entire Law of Indemnity in Contracts. Section – 124 of the Indian Contract Act, 1872 defines the “Contract of Indemnity”. The present definition of the Contract of Indemnity as defined under section - 124 is narrow and incomplete. It doesn’t cover in its ambit “loss caused by events or accidents” this deficiency is also felt by the Law Commission, therefore it also recommended addition of “or by any event not depending on such conduct” in the definition after “the conduct of any other person”. The researcher agrees to such substitution and is of the view that this substitution must be taken up to make the definition of the “Contract of Indemnity” comprehensive.

The recommendation of the addition of Section – 72A by the Law Commission under the Chapter Quasi-Contracts of the Act is made to include cases in which an act is done by one at the request of the other, the act in itself is not manifestly tortious to the knowledge of the person doing it but such act turns out to be injurious to the rights of the third party, the person doing it is entitled to an Indemnity from the one, who requested him to do the act. The researcher is in agreement to the addition.

The recommendation for the addition of Section – 125A, is also supported by the researcher, since the present section 125 of the Indian Contract Act, 1872, deals with the rights of the indemnified in the event of being sued only. On analyzing Section – 125 one may conclude, as also viewed by the Law Commission of India, that it only talks of “some” rights of the Indemnity-holder and these rights are further restricted, as they are available to the Indemnity-holder in the event of being sued only and not otherwise. The Law Commission by way recommendation of Section – 125A has tried to incorporate other rights available to the Indemnity holder in case of not being sued. The researcher is in agreement to such recommendation.

Further there was a disagreement between the opinions of various High Courts, as the law was silent, on the point as to when and what point of time can the Indemnity holder require the indemnifier to pay. Either the Indemnity holder has to wait till the actual loss is suffered or
the Indemnity holder can ask for payment, when the liability arises, irrespective of the actual loss suffered. There has been conflict of opinions on this point between various High Courts, which the Law Commission of India has tried to put at rest by recommending that the view of the Calcutta, Madras, Allahabad and Patna High Court is correct. The same is recommended by way of insertion of Section – 125A in the Act. According to which, the Indemnity holder can require the indemnifier to pay for the loss at the point when the liability of the Indemnity-holder to pay becomes absolute and/or has arisen, without waiting for the sufferance of the actual loss.

Initially, the Law of Indemnity under the Contract Act was silent on the following questions – Does the indemnified has only the rights mentioned under section 125 of the Indian Contract Act, 1872 for disposal? Whether there can be other remedies at the disposal of the indemnified in the event of not being sued? The Law Commission has tried to provide answers to these questions by way of recommending insertion of Section – 125A to the Indian Contract Act, 1872.

Supporting the rights and remedies of the Indemnity-Holder in equity as stated by the Halbury’s law of England, the Commission recommended that the section 125 needs to be more fully defined and remedies of an Indemnity holder should be indicated even in cases where he has not been sued. The above view is also supported by the researcher.

The researcher is of the view that since the time of coming into force of the Act, in 1872 the commercial world has grown by leaps and bounds; accordingly modern trends have come up. According to the researcher, “loss” is also an aspect of consideration as is mentioned in the definition given by Lush J., in Currie and Others v. Misa case, in the year 1875. On analyzing the definition of Contract of Indemnity given under Section-124 of the Act, one can easily conclude, that since “covering of loss” of the Indemnity-holder is the crux of the Contract of Indemnity and this “loss” forms the consideration in the Contract of Indemnity.

There have been judicial innovations with respect to the concept and movement of consideration in the Contract of Indemnity. The researcher is of the view that at the time of Currie v. Misa case, the Contract was based on “Profit and Loss” theory, under which as a corollary, the Indemnity-holder must not suffer the loss. However, today this theory has undergone a sea change, today in the commercial world the Indemnity clause, comes as an
attractive clause in the Contract. It imbibes the principle “that no one should suffer loss.” Under the Contract of Indemnity, initially one was content by the fact that the Indemnity-holder was indemnified by the indemnifier. Nobody went behind to look, that in case of indemnification by the indemnifier, it’s the indemnifier who is the true sufferer and is at loss. Today, the modern trend is in favour of looking behind it and suggests covering of the loss of the indemnifier from the actual wrong doer.

Such right is duly bestowed to the surety, in the Contract of Guarantee by way of Section – 140 which talks of the Right of Subrogation. But such right is not available to the indemni fier in case of the Contract of Indemnity. The Indian Contract Act, 1872 is silent on this point. With the advancement and need of the society, the judiciary evolves new principles, either they are present in the statute by way of right or they are bestowed to the party by way of remedy on the grounds of “justice, equity and good conscience” through Judicial Innovations. By way of Judicial Innovations, the Hon’ble Supreme Court in Munshi Singh case (1967) and Landmark Judgment of Constitution Bench in Economic Transport Organisation case (2010) (expressly provides for the right of subrogation inherent in the Contract of Indemnity on equitable principles) has tried to incorporate the principle of subrogation in the Contract of Indemnity by way of providing it as a remedy to the indemnifier to proceed against the wrong doer in case of his loss. The principle today focuses of the point that “no body in this civilized world should suffer loss”, this be the case the wrong doer must be asked to cover up the actual loss. By this the judiciary has tried to incorporate the concept of doctrine of subrogation in the law of indemnity, by stating that the courts are bound to abide the principles of natural justice. In Munshi Singh case (1967), under the Contract of Indemnity, it was said that when one promises the other to save him from losses, by covering them, the other party who promises to cover up the loss, and when he does so, does not get anything in return. Therefore, he is the person who is in actual loss. The courts by way of judicial innovations have allowed the indemnifier to claim the loss from the actual wrong doer. Subrogation is therefore, a “right” in Contract of Guarantee by virtue of the Act, but it is bestowed on the party as a “remedy” on grounds English principles of “justice, equity, and good conscience “through judicial innovation under the Contract of Indemnity. The researcher therefore submits that the right of subrogation, as incorporated in the Contract of Guarantee for the surety under section- 140, be inserted in the Contract of Indemnity.

The researcher also submits, that there is an implicit restriction in the remedy of subrogation, because “subrogation” can only happen when the wrong doer is any “person” (natural or not) from whom one can claim loss. In case the wrong doer is not a person, as is the loss caused by the natural events like flood, tempest etc. there is no body from whom the loss could be claimed. Therefore, there would be no subrogation in such situations.

Section – 125 states, what the Indemnity holder can claim from the indemnifier in case of loss as a matter of right, only in case of being sued. The areas of concern for the researcher – remedies available to the Indemnity-holder in case he is not sued and other remedies available to the Indemnity-holder on which the Indian Contract Act,1872 is silent, have been dealt with by the Law Commission, under which it has recommended insertion of Section – 125A in the Indian Contract Act,1872. This recommendation is also supported by the researcher.

Last but not the least, the above discussed recommendations, supported by the researcher, are still pending and as yet have not been incorporated in the law. It is humbly submitted that the recommendations of the Law Commission may please be taken up and accordingly incorporated in the Act. The researcher has also suggested a recommendation, with respect incorporation of the right of subrogation in the Contract of Indemnity, which may also be looked into and considered for recommendation for incorporation in the Act.

The analysis undertaken by the researcher in the above mentioned twelve cases of the Hon’ble Supreme Court has helped the researcher to have a deep insight on the areas of judicial innovation by the Hon’ble Supreme Court, especially with respect to consideration under the Contract of Indemnity. During the course of analysis, the researcher has found that in most of the cases, “consideration” which is fundamental in the formation of Contract, is taken as implied. The consideration in the Contract of Indemnity is “loss”. It is only in the Sumitomo Case that the researcher for the first time has come across the interpretation of “loss” to cover cases of “cost” too. The researcher is also of the view that after the analysis of the above cases it is sincerely felt that the recommendation of the Law Commission made in its 13th Report related to Contract of Indemnity must be duly incorporated in the Indian Contract Act, 1872. The Indemnity clause

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today forms the backbone of most of the commercial Contracts today be it national or international Contracts. Such clauses help in boosting the credibility of the business and providing more business. The Judiciary has tried to fill up the gaps in the legislations through judicial innovations, it has moved to the extent of incorporating the principle of subrogation within the Contract of Indemnity; which is expressly provided for in the Contract of Guarantee only under the Act. With the times, commercial principles change, initially the focus was that loss must be covered, but today the focus has elevated to a level that no one should suffer loss, meaning thereby that the actual wrong doer must be penalized, if in case the indemnifier has covered the loss of the indemnified, the indemnifier is free to recover that loss from the actual wrong doer. The Hon’ble Supreme Court has also interpreted the section of Indemnity in such a manner to cover the commencement of liability as the criteria of awarding loss and not the happening of the actual loss. A close proximity has to be seen between the risk and loss in question. In all the above mentioned cases, one can also see that the consideration in the Contract of Indemnity is nothing but a future and fluctuating concept. It runs as a golden thread in almost all the commercial Contracts today. A sound clarity on the concept of Indemnity would help the framers of the Contract to save themselves from unwarranted claims and at the same time help the parties to cover up such losses which they intended to cover.

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