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The Twilight of Contract of Indemnity in the Indian Contract Act, 1872: A Critical Analysis

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A contract of indemnity is a bipartite contract where one party promises to save another from loss incurred and would lead the other party harmless. The word indemnity means to render someone undamaged has been derived from 'indemnis' in Latin. A contract of indemnity fundamentally shifts the liability and burden from one party to another for the loss that is ancillary to the specified contract. The party that gets the protection is called the indemnity holder or the indemnified and the party that saves from such loss is called the indemnifier in these contracts. Generally, such contracts are not used separately but are combined in a clause with other instruments like guarantees in sale purchase of goods agreements and bank and other financial transactional contracts. The origin of the English law of indemnity is unclear and dubious but the judicial decisions in the 1860s – 1870s viewing the transfer of shares in corporations in the London Stock Exchange help in clarifying the same. This principle of indemnity was first identified with its effects in the English case of ***Adamson v Jarvis***[1]*, where the plaintiff sold certain cattle on the instruction of the defendant, and further, the facts unfolded to show that the cattle did not belong to the defendant in the first place. The plaintiff sued the defendant for the loss as he acted according to the direction given to him by the defendant under the contract of indemnity. The Indian Law defines the contract of Indemnity, its nature, and the rights of the indemnity holder in Section 124 and 125 of ICA respectively. This paper aims to throw some light on the limitation of the statute on the grounds of the scope within the ambit of the sections involved and makes suggestions with the help of the position of law in other jurisdictions mainly dealing with the English law.*

[1] *Adamson v Jarvis* [1827] 4 BING 66

keywords: *indemnity, contract act, Indian law, english law, indemnis.*

INTRODUCTION

THE SCOPE OF THE CONTRACT OF INDEMNITY UNDER ICA

- **Limitations of the definition**

Section 124[2] ICA defines an Indemnity contract as when one party assures to save the other from loss incurred to him by the act of any other person or by the conduct of the promisor himself/herself. The definition of indemnity under the English law is broader than provided in the Indian law as it protects the indemnity holder against loss occurred from any cause whatsoever. This includes loss covered in section 124 of the ICA along with the loss caused by accidents like fire, floods, earthquakes, etc. Under English law, any contract of insurance is a contract of indemnity except life insurance. Life insurance does not relate to the contract of indemnity as the insurer does not indemnify to pay the loss or pay a compensation amount upon the death of the party involved, but merely agrees to pay a sum assured in such a case[3]. Moreover, human life cannot be valued for a specific sum of money and hence cannot be a viable basis for indemnity contracts. The scope of 'indemnity' in ICA is restricted as it covers 'loss' that arises in two scenarios- firstly when the loss is caused by the action of the promisor himself, and secondly by the action of any third person, making it specific that the loss must be caused by a human agency. Further, when a strict interpretation of the section is done the case of Adamson v Jarvis, falls outside the ambit of section 124. The statute does not cover self-induced losses caused by the indemnity holder. The situation where the loss occurred from an act done at the request of the promisor is covered in section 223[4] of the act that deals with indemnity between principal and agent. In the thirteenth Law report by the Law Commission in 1958 suggestions were made to expand the scope of this section by the inclusion of scenarios where loss incurred to a party is not restricted to the conduct of a human agency, that covers

[2] Indian Contract Act, 1872, s 124
[3] Sakshi Agarwal, 'Contract of Indemnity in India & UK' (*Law Times Journal,* 10 August 2018) <https://lawtimesjournal.in/contract-of-indeminity/> accessed 02 May 2022
[4] Indian Contract Act, 1872, s 223

loss caused by unexpected events like fire, storm, etc.[5], yet no changes have been made to the 1872 act in this area. The promise of indemnity can be both implied or expressed and are subject to the facts and circumstances which surround the case. Implied contracts of indemnities are a creation of the law but they do not originate from the statute and their enclosure is a result of case laws driven by the courts in India. When we do a comparative analysis of the indemnity law in England, it is professed that the English law of indemnity is majorly a product of case laws. A Similar trend can be seen in other jurisdictions namely Singapore, Australia, Canada, and now as it can be seen in Indian law in the aspect mentioned[6]. The example of implied agency in Indian law is evident from the ***Secy of State for India v Bank of India Ltd***.[7] where the state was allowed to recover compensation from the bank when a forged endorsement was given when the true owner of the endorsement recovered compensation from the state.

The ICA in section 69[8], Chapter V deals with special cases of implied indemnity. According to this provision, if a person is interested in the payment of money that another is bound to pay by law and therefore pays it, then such person is entitled to be indemnified. Likewise, section 222[9] deals with the duty of the principal to the agent and provides the liability of the principal to indemnify the agent in respect of all amounts paid during a lawful exercise of his authority. The overlap of different sources of indemnity is well acceptable too under law. For example in the English jurisdiction, the surety's right to indemnity from the Principal debtor can be justified on equitable grounds, on an expressed or implied contract of indemnity, or lastly on the basic principle of contract law being that of unjust enrichment. The expectations from the provisions are just the protection of the parties affected.

- **No mention of the Rights of the Indemnifier**

[5] Law Commission of India, *Contract Act, 1872* (Law Comm. No. 13 1958) <https://lawcommissionofindia.nic.in/1-50/Report13.pdf> accessed 02 May 2022
[6] Courtney Wayne, 'Indemnities and The Indian Contract Act, 1872' (2015) 27 (1) National Law School of India, 66-68 <http://www.jstor.org/stable/44283647> accessed 02 May 2022
[7] *Secy of State for India v Bank of India Ltd.,* (1938) 40 BOMLR 868
[8] Indian Contract Act, 1872, s 69
[9] Indian Contract Act, 1872, s 222

Section 125[10] lays down the extent of such liability. The indemnity holder when acting within the scope of his/her authority is entitled to receive the following from the indemnifier when he incurs a liability-

- All the damages the indemnity holder paid in a suit to which the promise of indemnity applies
- All costs that the indemnity holder is liable to pay in bringing or defending the suit, provided that the indemnity holder acted in a manner a reasonable individual would have acted in the absence of any contract of indemnity. It is also required that he does not contravene the order of the promisor.
- All sums that the indemnity holder has paid in the suit as a term of compromise if the promisor authorized him to compromise the suit and does not go against the orders of the indemnifier and acted as a reasonable person would have acted in the absence of any suit.

Section 125 maintains silence regarding the right of the indemnifier and displays only his liability towards the indemnified party. Other concepts like that of guarantee make an explicit mention of the right of the surety under section 141[11] but the same remains absent within the ambit of section 125. This again limits the scope of indemnity law and by not giving equal weightage to both the parties involved in a contract the law conflicts with the standard of justice and fairness that the law in general aims to advocate. Although, it is worth mentioning at this juncture that it was held in ***Jaswant Singh v Section of the state***[12]that the indemnifier shall be entitled in the same manner as the creditor is against the Principal debtor. This further demonstrates the reliance on the case laws and their importance for Indian law of Contract.

COMMENCEMENT OF THE LIABILITY OF THE INDEMNIFIER

The original law was governed by the maxim *'you must be damnified before you can claim to be indemnified* that meant that indemnity was payable only after a loss has been incurred to the

[10] Indian Contract Act, 1872, s 125
[11] Indian Contract Act, 1872, s 141
[12] *Jaswant Singh v The State* (1966) CriLJ 451

indemnity holder. Presently this does not stand to be true. In the Bombay High Court judgment of ***Ganjan Moreshwar Parelkar v Moreshwar Madan Mantri***[13]**,** the court held that if the liability is absolute in nature then the indemnity holder can get the indemnifier to pay off the claim or he can pay a sufficient sum of money which would constitute a fund for paying off the claim whenever it was made[14].

Now the position of law is such that the indemnity is not to be necessarily given after the payment of the loss.[15] As soon as the liability becomes absolute and clear the indemnity holder should have the right to exercise the same[16]. The indemnifier's promise to indemnify is an absolute one. If the indemnity holder incurs a liability and that liability is absolute he can then reach out to the indemnifier to save him from such liability. In ***Nallappa Reddi v Virdhachala Reddi,***[17]the court held that the right arises as soon as the decree is passed against the promisee by the court. This development 125pment reduces the burden on the indemnity holder and saves time for all the parties involved as they are not required to wait for the judgment of the court anymore. But it is important that the notice should be given immediately after the incident. In ***Praful Kumar Mohanty v Oriental Insurance Co Ltd***[18], the court cited that immediately implied that the act to be done with all convenient speed, the thing should be done as quickly as is reasonably possible[19]. The law reserves its say through provision on the topics that surrounds loss that is indirect to the contract. There are no exceptions provided in the statute regarding the same. So will it be right to incur that the contract of indemnity covers all kinds of losses that arise concerning the transaction in question? And does this 'loss' include loss of business or the loss of revenue? There is a space of general contractual freedom that is granted to the parties in such contracts. Thus it becomes important for the party that indemnifies to put a cap on the extent of protection against loss and damages and carve out

[13] *Ganjan Moreshwar Parelkar v Moreshwar Madan Mantri* AIR 1942, BOM 703
[14] *Ibid*
[15] *Richardson Re* [1911] 2 KB 705 CA
[16] *Shiam Lai v Abdul Salam* AIR 1931, All 754
[17] *Nallappa Reddi v Virdhachala Reddi* (1914) ILR 37 MAD 270
[18] *Praful Kumar Mohanty v Oriental Insurance Co Ltd.,* (1997) AIHC 2822
[19] *Thompson v Gibson* [1841] 10 LJ Ex 243

the same around this area while drafting a contract of indemnity[20]. Also, there is often confusion that surrounds these types of contracts and the contract of insurance as they have more similarities than differences. It is to be noted that indemnity is much broader than the concept of insurance. The requirement of a 'premium' sum to be paid by the person getting the insurance is a significant difference as it is absent in the contract of indemnity.

CONCLUSION

Indemnity contracts have developed to turn into a fundamental part of commercial law and these clauses are important safeguards for future financial outgoing and may not be recoverable against the 'damages' clause of a contract as these losses may not be attributed to the fault of any party. By expanding the extent of the liability, the burden on the indemnifier would be all the more, yet the indemnifier consistently has a leeway by restricting such liabilities through the imposition of monetary or another type of cap. The primary embodiment of such contracts is to cover the loss incurred to the party involved, so the limit of the nature of such loss shall not be a standard for verifying the same. An amendment in the act for broadening the definition of indemnity is hence required and is necessary for clarity. By rendering such concepts coherent and lucid the time of the courts can be saved, especially in a country like India where there is a mountain of cases with the judiciary. The law has developed to include implied indemnity and has also progressed and dealt with important clarification with regards to commencement of liability. Consequently, the take of English law in including loss that occurred through non-human agency ought to be seriously taken into consideration as suggested by the Law Commission. By restricting its scope, the law fails to safeguard the indemnified in a situation where the loss caused by accidents is enormous and the requirement for security is the most extreme necessity. It hinders the principle of equity and good conscience that is a pillar and a mainstay of the Indian Contract Act.

[20] Garima Bharati, 'Indemnity: Safeguard against future financial exposure' (*Live Mint*, 14 February 2010) <https://www.livemint.com/Politics/CgtgAEPL8nShjil5zrcERN/Indemnity-safeguard-against-future-financial-exposure.html> accessed 02 May 2022