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Indemnity: A Paradoxical Puzzle in Indian Labor Contracts

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ABSTRACT

An indemnity clause is an essential aspect of any contract, but it is undoubtedly the most important clause in a labour and employment contract. A well-drafted contract will always have an indemnity clause. In labour and employment contracts, an indemnity clause can often be one-sided, if it is present at all. Labour contracts are a rare sight, and in their occurrence, they are generally Labour-centric, even though not implemented very well. Employment contracts are a must, and so are the indemnity clauses present in them. However, they are extremely employee-centric. Therefore, in this research paper, I will first explain what the terms, indemnity, labour, and employee mean. I will go on to analyze the concept of indemnity, followed by analyzing the implementation of indemnity in labour disputes and employment bonds. Lastly, I will unravel the complexities of indemnity clauses in labour disputes and employment contracts, before giving my recommendations and opinions.

***Keywords**: Indemnity, Labour disputes, employment contracts, indemnity clauses, employment bond.*

I. INTRODUCTION

The word 'indemnity' stems from the Latin word 'indemnis' meaning, to render one undamaged. Indemnity, in simple words, means, to make good a loss. It is a legal provision that allows to transfer of liability from one party to the other, under certain circumstances which are laid out in the contract. The party which is protected against the liability is the 'indemnity holder' and the party providing such protection is the 'indemnifier'.

Generally, indemnity is added as a clause in contractual agreements, however, a separate contract of indemnity may also be drafted for the purpose. As part of a larger contract, an indemnity clause is generally limited to the contract at hand, and situations that may arise out of it. It is specific to the actual contract. In the case of a full-fledged contract of indemnity, since it is an independent agreement, it is broader and the scope of it can be expanded to multiple situations that may arise out of the overall relationship between the parties involved, and not a

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specific agreement.

A simple example of indemnity could be a rental agreement, wherein the lessor (landlord) may ask the lessee (tenant) to indemnify him from any damage caused by the lessee during the course of the tenancy.

Although the terms ‘Labour’ and ‘employee’ are many a time used interchangeably, there are several differences between them. Labour is a broad term including employees as a whole and this includes freelancers, independent contractors, daily wagers, and so on. An employee on the other hand, refers to specific individuals and their employment contracts. There is a contractual relationship between an employer and employee, which is not as stringent in the case of Labour, wherein the focus is more on the work rather than the contractual relationship. The nature of the working relationship is the primary distinction.

An indemnity clause in a Labour and employment contract is aimed at protecting the employee, employer, and both, or all parties involved in the contract from certain losses that may be incurred. The indemnity clause is incorporated in the employment contract which every employee is made to sign as a first step towards an employer-employee relationship. The primary objective of indemnity clauses in Labour and employment contracts is risk mitigation. The specific circumstances required under indemnity clauses can vary, but in general, they include negligence, misconduct, breach of contract, and intellectual property infringement, amongst others.

II. Legal framework

(A) Indemnity

Section 124 of The Indian Contract Act, of 1872 defines a “contract of indemnity” as a ‘promise’ to save one party from ‘loss’ suffered by them, due to the ‘conduct of the promisor’ or ‘the conduct of any other person. It must be noted herein, that Section 124 refers to a ‘contract’, and for a contract, there are certain necessary elements, including free consent, competency of parties, lawful consideration, and lawful object, and they must not be void in nature. The requirement of ‘lawful consideration’ in a contract, given under Section 10 of the Indian Contract Act, is lacking in the definition of a “contract of indemnity” under Section 124. A contract must be bilateral, however, this Section deals with the consideration of one party alone. Thus, it begs the question, if lawful consideration is a must for a contract, how can it be excluded from a contract of indemnity? This lack of clarification sets grounds for the interpretation that there must be an existence of a valid contract between the parties, following which, an indemnification clause or contract can be sought if need be.

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Section 124 also requires the promisee to suffer "loss" in order to claim indemnity. However, is actual loss required? For instance, if in a commercial rent agreement, the lessee (promisor) has promised to indemnify the lessor (promisee) from any repair charges, should the lessor (promisee) have to pay the charges first to prove "loss" before claiming indemnity from the lessee (promisor)? Or, can the lessor (promisee) ask the lessee (promisor) to pay the charges directly? The question of actual "loss" in Section 124 of the Indian Contract Act has been settled in the case of Gajanan Moreshwar v. Moreshwar Madan[2], wherein the Bombay High Court held that if the indemnity holder has incurred an absolute liability, he has the right to ask the indemnifier to indemnify him against the same. The rights of the indemnity holder are in addition to the other rights given under Sections 124 and 125 of the Indian Contract Act. If the indemnity holder has to wait for a judgment in order to sue the indemnifier and claim indemnity, clearly, it would be burdensome for the indemnity holder. Therefore, the Court settled that actual loss must not be proved, as long as an absolute liability has been incurred by the indemnity holder.

Additionally, the indemnifier's duty to indemnify the indemnity holder from any loss caused to them by the 'conduct of the promisor' or 'the conduct of any other person, limits the scope of the Section and lacks clarity with respect to 'force majeure'. Is the indemnifier obligated to indemnify the indemnity holder in cases of 'force majeure', which basically refers to unforeseen events, not within the control of a human being? This includes 'acts of God' and natural disasters, such as fire, storm, war, flood, and pandemics such as Covid-19. Should the indemnifier have to pay for the losses suffered due to an act caused by no one, neither the promisor nor any third person, considering such 'acts of Gods' or natural disasters are not caused by any 'person' per se? Further on, in cases of natural disasters and Acts of Gods, force majeure can be taken as a defence to avoid the granting of indemnity. Generally, contracts have a clause providing for force majeure events, however, even if such a clause is missing, Section 56 of the Indian Contract Act outlines the Doctrine of Frustration. This allows the indemnifier to deny the claim of an indemnity holder, bearing a high burden of proof, to demonstrate that under the given circumstances, it is "impossible or unlawful" to indemnify.

Furthermore, Section 125 of the Act talks about the rights of indemnity holders when sued. If sued, the indemnity holder has three options through which he/she can recover the dues from the promisor. Firstly, the indemnity holder can claim damages via court order. Secondly, the expense of fighting the lawsuit as per the contract with the promisor, or as a prudent person

[2] Gajanan Moreshwar v. Moreshwar Madan, A.I.R. 1942 Bom, 302

would, can be recovered. Lastly, the indemnity holder might decide to settle instead of pursuing litigation, in which case the same can be claimed provided there has been no violation of terms of the agreement between the indemnifier and indemnity holder, and that they must have acted as any prudent person would. However, there is no mention of the rights of the indemnifier in any scenario, throughout the Act, thereby limiting the scope of the law on indemnity, and hampering the interests and rights of the indemnifier in the contract.

(B) Indemnity and Labour Disputes

Although the two sections pertaining to indemnity in the Indian Contract Act, of 1872, seem quite limited, several judicial precedents have expanded their scope, as well as with respect to indemnity in labour and employment contracts specifically.

In K. Sivaraman v. P. Sathishkumar[3], Justice D.Y. Chandrachud, while speaking of The Employee's Compensation Act, 1923, highlighted as under:-

"25. The 1923 Act is a social beneficial legislation and its provisions and amendments thereto must be interpreted in a manner so as to not deprive the employees of the benefit of the legislation. The object of enacting the Act was to ameliorate the hardship of economically poor employees who were exposed to risks in work, or occupational hazards by providing a cheaper and quicker machinery for compensating them with pecuniary benefits. The amendments to the 1923 Act have been enacted to further this salient purpose by either streamlining the compensation process or enhancing the amount of compensation payable to the employee ."

The very objective of this Act is to protect the economically backward employees who must be compensated for and indemnified against the losses suffered by them due to the risky nature of their work.

Section 12 of The Employee's Compensation Act, 1923 deals with compensation for a worker in case of accidents occurring while undertaking any work for the Principal Employer while under the employment of a Contractor. Section 12(1) of the Act imposes upon the principal employer the duty to indemnify and compensate an employee of a contractor they have hired, for any loss suffered during the course of his/her duty. In Section 12(2) though, the principal employer can recover the amount from the contractor, or if a contract is not available between the principal employer and the contractor, the issue could be settled by the Labour Commissioner. Under Section 12(3), a worker is also entitled to claim such indemnity by the contractor. The Gujarat High Court, in the case of **Bil Metal Industries v. Rameshbhai**

[3] K Sivaraman v. P. Sathishkumar 2019 SCC OnLine SC 1759

Gordhan Bhai Solanki & Anr[4], held that under Section 12(1) of the Employees Compensation Act, a principal employer is liable to compensate a worker and may recover such amount from the Contractor, as per Section 12(2) of the Act. In the presence of a contract between the contractor and principal employer pertaining to such indemnification, the rights of the principal employer are laid out as per an express contract, therefore there is no conflict. However, if there is no clause of indemnity or a contract between the contractor and principal employer, the matter is raised to the Commissioner.

The Employee's Compensation Act's objective is to indemnify employees in cases of injury by accident. For the purpose of this act, an "employee" refers to a railway servant as defined under clause (34), Section 2 of the Railways Act, 1989, a master, seaman, or member of a ship's crew, a captain or member of an aircraft's crew, a person employer in any capacity in relation with a motor vehicle, and a person working abroad with a company registered in India. As highlighted in the judgement of the Punjab and Haryana High Court in the case of **Executive Engineer/Deputy General Manager, DHBVNL Bhiwani v. Priyanka**[5] as well, it was held that for the employee, Section 12 is advantageous as it allows them to claim compensation from the principal employer, who can further be indemnified by the contractor, if there is any. The principal employer would be as liable to compensate a contractor's employee, as he would be if the employee was directly employed by him.

Even though this section protects the labour, the issue herein is, that several times, there is no express contractor between the labour and contractor, and to claim indemnity from the contractor, one must prove a contractual relationship between the two and for the labour to do so, it is very difficult due to lack of legal awareness and financial support. The Supreme Court in a landmark judgement titled **Mackinnon Mackenzie & Co. Pvt. Ltd. v. Ibrahim Mahommed Issak**[6] held that there must be a causal relationship between the accident and employment, in order to claim compensation under the Workmen's Compensation Act 1923.

(C) Indemnity and Employment Contracts

Employers also take several measures to ensure that the company does not harm from the acts of employees, and therefore, often employees are made to sign an employment contract including an indemnity clause. Mostly, protection of the confidentiality of work is the primary purpose, nonetheless, often, negative covenants in the employment contract result in disputes.

[4] Bil Metal Industries Ltd. v. Rameshbhai Gordhan Bhai Solanki and Another 2016 SCC OnLine Guj 10001

[5] Executive Engineer/Deputy General Manager, DHBVNL Bhiwani v. Smt. Priyanka 2017 SCC OnLine P&H 466

[6] Mackinnon Machenzie and Co. Ltd. v. Ibrahim Mohd. Issak (1969) 2 SCC 607

Such negative covenants often prevent employees from working for other organisations in similar work during and at times, even after the course of employment. It could also lock in employees from resigning before a specific time period. This could be in conflict with an employee's freedom to practice any profession under Article 19 of the Constitution of India.

While the Delhi High Court in **Desiccant Rotors International (P) Ltd v. Bappaditya Sarkar**[7] held that in a conflict between an employer's protection from competition and an employee's right to choose any profession of their choice, the Court held that *"it is clear that the right of livelihood of the latter must prevail",* the Supreme Court in **Superintendence Co. of India v. Krishan Murgai**[8], held that negative covenants are valid during the employment as it is like 'a servant's duty of fidelity', and therefore, reasonable. The phrase used herein means that a servant (employee) has a fiduciary duty to put the interests of his master (employer) first. However in evolving times wherein we are now reminded time and again to refer to the 'servants' at our house as 'domestic help' or 'helpers' to uphold human dignity, it seems quite ironic that an employer-employee relationship can be equated to a master-servant one. Despite the need for confidentiality and avoiding conflict of interest, as a whole, it is a paternalistic idea that is contrary to the need for mutual respect and professionalism in the modern workspace.

The above judgement delivered by the Apex Court, in my opinion, is quite problematic, which is probably why in **Niranjan Shankar Golikari v. The Century Spinning and Mfg. Co**,[9] further clarified its stance by citing a Calcutta High Court judgement which stated as under:

"*An agreement to serve a person exclusively for a definite term is a lawful agreement, and it is difficult to see how that can be unlawful which is essential to its fulfilment, and to the due protection of the interests of the employer,* ***while the agreement is in force."***

The emphasis on 'while the agreement is in force' clearly shows that negative covenants are reasonable only as long as they do not extent beyond the duration of employment. Such covenants would undoubtedly be void, as specified in Section 27 of the Indian Contract Act, 1872 which states that any agreement restraining the exercise of a lawful profession, business, or trade, is void, with the exception of businesses whose good-will has been sold.

Further, the Delhi High Court, in the case of **Sicpa India Limited v. Manas Pratima Deb**[10], declared the employment bond between the employer and employee unenforceable and unreasonable due to the absence of proof of any contended training, as well as because the

[7] Desiccant Rotors International Pvt. Ltd. v. Bappaditya Sarkar & Anr. 2009 SCC OnLine Del 1926
[8] Superintendence Co. of India v. Krishan Murgai (1981) 2 SCC 246
[9] Niranjan Shankar Golikari v. Century Spg. And Mfg. Co. Ltd. 1967 SCC OnLine SC 72
[10] Sicpa India Limited v. Manas Pratima Deb 2011 SCC OnLine Del 4805

period of contract was close to expiry. There was no finding about whether or not such contracts are generally enforceable but it can be inferred that for an employment bond to be enforceable, it must be reasonable and backed with substantial proof. What exactly qualifies as 'reasonable' for an employment contract, is not clearly defined anywhere but it would include a similar yardstick as to that of any other contract, such as if there is proof of coercion. On the other hand, in **Toshniwal Brothers (Pvt.) Ltd. v. E. Eswarprasad & Ors**[11], the Madras High Court held the employee liable to pay stipulated damages worth 25,000. The Court stated that an employer need not prove post-breach damages; a pre-estimate of damages is sufficient.

Further, the employer had to prove that an employee had received special training, in order to presume legal injury:

"where the employer or the management concerned was shown to have either incurred any expenditure or involved itself into financial commitments to either give any special training either within the country or abroad or in having conferred any special benefit or favour to the detriment of the claimant in favour of the violator involving monetary commitments."

The Andhra Pradesh High Court, in **Satyam Computer Services Limited v. Ladella Ravichander**[12], held that an employer must prove that actual loss or damage has been caused to the company due to the actions of the employee, which in this case was the abrupt resigning of the defendant from the company.

By comprehensively analysing the above-stated judicial precedents alongside the provisions of the Indian Contract Act 1872, we can conclude that employment bonds are enforceable if the employer has invested in the training of an employee in lieu of the employee serving the employer for a specific duration as stipulated in the contract. Additionally, the employer must have suffered a loss due to the employee's breach of contract. Lastly, the negative covenants in the contract should not be unreasonable and arbitrary.

III. Unravelling complexities in labour and employment contracts

So far, we have seen that indemnity clauses in labour disputes are labour-centric, whereas, in individual employment contracts, indemnity clauses are employee-centric.

The functioning of labour and employment contracts is of course not as straightforward as it appears from the wording of a contract. An indemnity clause in a contract may seem beneficial for the worker, however, several complexities unravel when it comes to implementation. Firstly,

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[11] Toshniwal Bros. Ltd. v. E. Eswarprasad 1996 SCC OnLine Mad 36

[12] Satyam Computer Services Limited v. Ladella Ravichander 2011 SCC AP 76

the labour class is seldom aware of their legal rights, and even if they are, it is financially burdensome for a labourer earning a daily wage of about 500 rupees, to afford even a decent lawyer. Without a lawyer, it is difficult to fulfil the burden of proof on the labour that the injury took place at work, and that the labour was undertaking all safety precautions, such as wearing safety headgear when the injury happened.

Moreover, the most difficult issue faced by a labourer, especially a daily wage worker, is to prove that they are under a work contract with the employer/contractor. Labourers belong to socio-economically backward classes. They are vulnerable to exploitation since they are less familiar with labour laws, and rights. Further, their knowledge and understanding of legal documents is limited, if any. They are desperate for jobs, so much so that they are ready to accept unfair work terms and conditions, and are at no position to negotiate. The power imbalance between a labourer and their contractor gives the latter an upper hand in contractual agreements between the two. Often, there is no written contract between the two, and this lack of documentation and salaries in cash makes it easy for a contractor to wiggle out of their liabilities.

When it comes to employment contracts, these are individual contracts for an individual worker, and generally, the objective is to hold the employee liable for legal action against the employer due to their employment.

Although a contract is supposed to be 'fair', holding an employee liable for their honest mistake is not quite fair. Further, an employee is almost always at a weaker position to bargain, therefore, at first, it is difficult to fathom the extent to which the indemnity clauses can be unreasonably enforced against them. For an employee to dispute the enforceability of an indemnity clause under their employment contract is a big step. It is risky, expensive, and can result in unnecessary termination under the guise of 'unsatisfactory performance'. Whereas there are legal provisions that can protect the employee from an arbitrary contract, seemingly signed under 'undue influence', the primary objective of an employer is to protect the company and they use the higher bargaining power to agree to a settlement, which can often be pennies on the dollar.

IV. Conclusion

In my opinion, it is very important for the government to mandate basic legal awareness workshops for all employees in every workspace. The objective should be to make an employee understand their legal rights so that they can be at par with the employer while signing an employment contract, negotiating terms and conditions, and most importantly, protecting them

from exploitation. Similarly, legal awareness camps should also be held in residential areas for the benefit of labourers. It is of utmost necessity to make labour laws more stringent to protect the rights of the workers. The more the surveillance, the better would the treatment of workers be. While the law does protect the rights of workers and employees, the Court can only ensure their implementation if such cases are reported as frequently as their occurrence. Often, even if a case is reported and taken up by the District Legal Services Authorities, the legal services advocates are overburdened with cases and the marginalized sections of society rarely get the aid they are supposed to get. This is the sad reality of our country, and it is time we change it.

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