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Ambiguity in Contract of Indemnity

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ABSTRACT

It is astonishing to see that only sections 124 and 125 of the Indian Contract Act of 1872 address "contracts of indemnification," a crucial and often used legal document in the mercantile community. In the first section, indemnity is defined, and in the second, the rights of an indemnity bearer are discussed. The Indian Contract Act of 1872, which has only two parts, has certain significant concerns that are not directly addressed. Also, it appears that there hasn't been much of a divergence from the statutory language employed in these two parts based on judicial interpretation and subsequent developments in the law of indemnification. This paper tries to highlight such ambiguity which is faced by the court to properly interpret the indemnity contract.

Keywords: *Indemnity, Liability, negligence, Ambiguity.*

I. INTRODUCTION

The term "indemnity" means to provide security as well as protection for a financial burden against liability for a person or a third-party action. It talks about the contractual obligations of a party to pay the other party the loss incurred due to the results of his or any third party's conduct.

A contract of indemnification is defined by **English law** as "a guarantee to protect a person harmless from the consequences of an act"². As a result, it covers damages brought on by natural disasters as well as those caused by human action, produced by a mishap, a fire, or another disaster of nature.

In India, the contracts are governed by the "Indian Contract Act, ICA Act of 1872." Indemnity is defined as "A contract by which one party promises to protect the other against loss caused to him by the behavior or conduct of the promisor himself, or by the action of any other person," as per S.124 of the ICA.³

The next Section.125 talks about the rights of the indemnity holder, it also identifies the importance of the reasonable steps taken by the indemnity holder to mitigate the risk of the

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² Academia, Contract of Indemnity & Guarantee,

³ Indian Contract Act, 1872, § 124

damage.⁴

Through several rulings over time, the Indian courts have improved and further expanded the law of indemnification contracts. In this context, in “**Union of India v. Raman Iron Foundry**,”⁵ is one of the key instances. According to the Supreme Court of India's ruling in this case, “an indemnity contract is a legal arrangement wherein one party promises to protect the other against impending losses or make up for losses that have already transpired”.

“**National Insurance Co. Ltd. v. Boghara Polyfab Pvt. Ltd.**,”⁶ a landmark case that has had a major influence on the legal evolution of indemnification contracts. The Supreme Court ruled in this case that an indemnity contract's terms must be rigorously interpreted and that the party providing the indemnification is not able to seek reimbursement from the indemnifier for losses that fall outside of the bounds of the agreement.

An indemnity contract can be both expressed as well as implied, supreme court held in a landmark decision that "the pre-existing implicit right to indemnification guaranteed by Indian law does not require a written indemnity clause."⁷

II. IMPORTANCE

“The Indian Contract Act of 1872” recognizes several essential contract types, including the indemnity contract. It enables parties a legal mechanism via which they can secure themselves from future harm or losses. Following are a few instances highlighting the significance of the indemnity contract under the Indian Contract Act:

- Protection from legal liability:

One of the major importance of an indemnity agreement is that it can shield the party receiving indemnification from possible liability. A contract of indemnity can offer security against damages brought on by the action of the Indemnitor or any other person, as stated in Section 124 of the Indian Contract Act. For instance, the court determined that an insurance policy's obligation of indemnity protected the insured against damages brought on by occurrences covered by the policy in “**New India Insurance Co. Ltd. v. Genus Power Infrastructures Ltd.**”⁸

- Assuring the parties:

⁴ Indian Contract Act, 1872, § 125

⁵ Union of India v. Raman Iron Foundry, (1974) 2 SCC 231

⁶ National Insurance Co. Ltd. v. Boghara Polyfab Pvt. Ltd., (2009) 1 SCC 267.

⁷ The Secretary Of State vs The Bank Of India Limited (1938) 40 BOMLR 868

⁸ New India Insurance Co. Ltd. v. Genus Power Infrastructures Ltd., (2015) 2 SCC 424.

The contract assures the parties that in a case of a financial mishap they will be protected under the Indemnity Act. In particular, in circumstances when one party is taking on a sizable risk or obligation, this might be particularly crucial. According to “Section 125 of the Indian Contract Act”, the indemnity holder is entitled to compensation for any losses or damages sustained as a result of the contract's covered incident.

- Allows businesses to expand without taking on excessive risk:

The contract of indemnity also could allow enterprises to grow their operations as well as take on new ventures. For instance, a construction company might sign an indemnity agreement with a subcontractor to safeguard itself from any losses that might result from the subcontractor's actions. This might provide the construction company with the assurance that it won't be held accountable for any injury the subcontractor creates.

III. SHORTCOMINGS IN THE CONTRACT OF INDEMNIFICATION

The extent of the liability incurred by the indemnifier is not clearly expressed:

“The Indian Contract Act of 1872,” contains two provisions (124 and 125) that deal with contracts of indemnification, but these have a limited scope and do not address several crucial concerns. The obligation of the indemnifier is not expressly stated in the Act, which sometimes presents challenges in interpretation.

- Contradiction in the language of S.124

The terminology “TO SAFE” is used in Section .124 of ICA, which denotes that the Section is **preventive**, but the section only comes into force provided the contract fails. There is a clear contradiction between the words used and the overall interpretation of the section.

There is combined negligence of the contractor or lessee and the owner:

In the cases, if the mistake is of the contractor the legal jurisprudence is well settled as in the contract is liable to pay the damages, but in the cases where the owner or its employees are also a cause for the damages that occurred, so in the scenario there is a combined liability, the ICA, doesn't provide with any clear answer to it and as a result, it is a huge interpretational dilemma.

In the Wisconsin case of “**Criswell v. Seaman Body Corp**”, the owner of the building was found responsible to a subcontractor's employee for not adhering to the Wisconsin Safe-Place Act. Notwithstanding the owner's lack of intentional carelessness or blame, there is a legal need to offer a "safe place" of employment. The ICA doesn't provide any clear answer to it and as a

⁹ Criswell v. Seaman Body Corp 233 Wis. 606, 290 N.W. 177 (1940).

result, it is a huge interpretational dilemma.

- There is sole negligence by the owner:

In cases where the owner shouldered the whole blame of negligence, will a "contract of indemnity" be applied there? The vagueness and incomplete drafting again lead to another interpreting issue. Automobile insurance is a kind where the owner can be solely responsible for the incident. Securing consent to an indemnity contract that stipulates the contractor would have to pay for losses caused even as a consequence of the owner's carelessness presents apparent difficulties for the court when there isn't any detailed drafting of the said contract which individually deals with these issues. It should be emphasized, nonetheless, that the House of Lords believed that the essence of indemnification is grounded in losses rather than in debt in the context of insurance.¹⁰

- Drafting problems:

The drafting of the indemnification contract is very obscuring, and mainly the issue relating to the indemnity are compromised outside as it is not very easy to pinpoint the cause of the damages, as everyone shifts the blames to another. The owner will blame the contractor, while the contractor will blame the owner, and so on. Also, whether the claim actually "**arose out of**" or was "**connected to**" the fulfillment of the contract can also be frequently disputed.

- No definite scope:

The Indian Contract Act of 1872 is ambiguous on the extent of the range of indemnity, The sorts of damages that may be compensated or the maximum indemnity are not specified in the Act.

- Uncertainty About Third-Party Claims:

The Indian Contract Act of 1872 is ambiguous on the indemnity holder's right to compensation arising out of the damages done by the indemnifier in the event of a third-party claim. The Act makes no mention of the conditions whereby a third party may request indemnification or the rights of the indemnity holder in such circumstances.

- Ambiguity in S.125 regarding indemnity holder:

Although Section 125 specifies the indemnity holder and their rights, it doesn't go into detail on the specifics of such rights. The right of the indemnity holder to collect costs, including legal fees, spent in defending a claim is not clearly defined.

¹⁰ "The Fanti and the Cadre Islands" *Firma C-Trade SA v Newcastle Protection and Indemnity Association* [1991] 2 AC 1.

- Rights of indemnity holder:

The rights of the indemnity holder only come into place when the indemnity holder is **sued** in the court of law, if the right of the indemnity holder is breached the indemnity holder can only rely on the right if he is sued in the court of law.

IV. CREATIVE APPROACHES TO COUNTER THE SHORTCOMINGS

- Amendments to fill the ambiguity:

The various dilemma like: What if the damage is caused by?

- solely the owner,
- combined negligence by the owner and the indemnifier,
- solely by the third party

all these complications as well as ambiguity in Section (124,125) should be cleared by the way of amendment so there can't be any ambiguity among various courts to interpret the section.

- The use of clear and precise vocabulary:

The drafters while drafting the indemnity contract, used contradicting terms, there should be clear and precise vocabulary used to prevent misinterpretation of the indemnity clause. The term "safe" is preventive and the main objective of the contract comes into force after there is damage, so the vocabulary is counterintuitive.

- Comprehensive coverage

The scope of the indemnity agreement must be expanded to endure and cover all types of losses or damages, in addition to monetary damages, to ensure that the promisee is adequately protected.

- Specification of the claim

To eliminate the dispute from where the claim arises, out of the performance of the contract or related to the performance of the contract. To avoid this issue, indemnity provisions should include wording that both refer to the final facts (such as "**claims arising out of the contract**") and the situation at hand.

- Preference to be given to the indemnifier

“The contract of indemnity” shall be constructed very strictly and an indemnification provision must be interpreted closely, and any ambiguity should be resolved in the indemnifier's favor.¹¹

¹¹ Andar Transport Pty Ltd v Brambles Ltd (2004) 217 CLR 424 at [17] – [23].

Doubt can either arise not only from the misinterpretation of a particular expression but also from the possibility of its application.

V. CONCLUSION

Despite various shortcomings, the indemnity contract continues to be a crucial legal instrument in Indian society. It offers a useful framework for preventing financial losses and encouraging ethical conduct among people and organizations. But still, it is crucial for people to thoroughly evaluate the conditions and restrictions of any indemnification contract before signing it. Even if it is not a perfect answer, the “contract of indemnity” is a vital part of Indian culture since it offers security and protection to both people and corporations. Individuals and organizations can take use of this legal instrument by being aware of its restrictions and thoroughly reading any contract's conditions.

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