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Critical Analysis of Contract of Indemnity

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ABSTRACT

This article offers a thorough examination of indemnification agreements made in accordance with the Indian Contract Act of 1872. According to the definition of indemnity, which is "Assurance against loss," indemnification is paying a person for losses or damages brought on by their own actions or those of another party. Sections 124 and 125 of the Act, which describe the characteristics of indemnity contracts and the rights of the indemnity holder, are examined in this research. However, it draws attention to the fact that there are no provisions defending the indemnifier's rights, which leaves room for legal ambiguity and gaps.

The essay discusses a number of concerns, such as ambiguities in contract provisions, problems with reciprocatory contracts, issues with privity to contracts, and difficulties brought on by changes in the market. It also examines the need for better language to specify the indemnifier's advantages and makes suggestions for changes to Section 124's definition of loss and rights.

The study also examines implied indemnity contracts and the difficulties they provide, highlighting the significance of transparency and equity for both parties. It emphasizes the fact that a simple indemnity provision cannot release a negligent party from liability.

Lastly, the article advocates for an amendment to the Indian Contract Act to ensure equity and justice for both parties involved in indemnity contracts, as well as to resolve ambiguities and promote a fair resolution of liability issues.

Keywords*: Indemnity, Section 124, Section 125, Indian Contract Act 1872, reciprocatory contracts.*

I. INTRODUCTION

In its precise definition, Indemnity is described as *"assurance against loss."* Indemnification is the contractual obligation of one party to compensate the other for losses or damages that have occurred or may occur as a result of his or any other party's behaviour. Several clauses of the Indian Contract Act, 1872 ("the Act") outline the nature of an indemnity contract and the promisee's rights under it.[2] The term indemnity comes from the Latin word *"indemnis",* which

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[2] Sections 124 and 125, Indian Contract Act, 1872. Sections 77 and 78 of the Malaysian Contracts Act, 1950 are in almost identical terms

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literally means "*unharmed or undamaged*."[3] A risk shifting is a contract in which the risk of losing money is transferred from the promisee to the promisor. Indemnity can be compared to a pendulum, in which the bobs return to their original position after being put in motion. As a result, indemnification is the impetus behind a promiser restoring the promisee's former position.

The act of substituting one party for another whose debt is being paid, so granting the paying party rights, remedies, or security that would otherwise belong to the debtor.[4]

When one of the parties insures the other party against the risk of losses connected with a concluded contract, and the premium for accepting the risk is included in the contract price[5].

All of these formulations emphasise the *risk-shifting element* of indemnification.

II. CRITICAL ANALYSIS

(A) Section 124 And Section 125

A contract of indemnity is defined under Section 124 of the Indian Contract Act as "*Contract by which one party guarantees to save the other person from loss caused to him by the action of the guarantor himself, or by the action of any other person*."[6]

Whereas, according to English law, it is defined as: "*A contract in which the indemnifier agrees to compensate the person indemnified for any damage incurred as a result of his engaging in a certain transaction.*" An indemnity (in this sense) differs from a suretyship in that the indemnity is a separate (main) commitment, whereas the suretyship is a collateral, accessory, or subordinate obligation.[7]

Now after reading section 124, one may assume that it's the indemnified who enjoys the benefits as the section clearly talks about it.

The devil comes out in details of section 125 of the similar act. Section 125 of the Indian Contract Act, 1872 says*, "The promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promiser-*

(1) all damages which he may be compelled to pay in any suit in respect of any matter to which

[3] Sakshi Agarwal, Contract of Indemnity in India & UK, Law Times Journal (accessed at march 21,2022) http://lawtimesjournal.in/contract-of-indeminity/
[4] Henry Campbell Black, Black's Law Dictionary, 1427 (J.R. Nolan,St. Paul: West Publishing Co., 1990)
[5] Alexander V. Syatchikhin, Indemnity (Compensation For Losses) And Liquidated Damages: The Difference Of Institutions In English Contract Law, 1 Russian Law: Theory And Practice 68, 69 (2020)
[6] The Indian Contract Act, 1872, Section 124, No. 9, Acts of Parliament, 1872 (India)
[7] Singh Jigisha, Concept of consideration in contracts: A study with reference to law of indemnity and guarantee, Shodhganga (2017) http://hdl.handle.net/10603/245806

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the promise to indemnify applies;

(2) all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promiser, and acted as it would have been prudent for him to act in the absence of any contract of indemnity, or if the promiser authorised him to bring or defend the suit;

(3) all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promiser, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promiser authorised him to compromise the suit."[8]

When one starts reading the section, one would realize that it talks about the rights of the indemnified but what about the rights of the indemnifier and what are the protections offered to him? Surprisingly, the Indian Contract Act 1872 remains silent over it as there is no mention of it.

(B) Recognised Loopholes and Problems

1. In regards of ambiguity in sections

One party promises to safeguard the other from "*loss caused to him*" as a result of the promisor's or any other person's conduct, according to Section 124. It is stipulating that the promisee will only be considered compensated if and when he has sustained a loss. Section 7 on the other hand, specifies that acceptance of a contract must be *"absolute and unqualified." "Because section 124 is also a contract, it must have all of the elements of a valid contract."* It's possible that a risky interest won't be insurable. However, in this situation, it is not absolute and unqualified since there are some explicit future requirements that may or may not be a need for implementing the indemnification contract lawfully. As a result, there is a void that must be filled, which should be taken into account and filled. A "*meeting of minds*" is also required. Both parties are in agreement, although not totally, when it comes to compensation after a loss. After that, in how much time it must be reimbursed? What is the most reasonable way to compensate for a loss? Etc. remains in the bubble created by neither the indemnifier nor the indemnity bearer. As a result, considerable ambiguity exists. In commercial conversations, limiting and outlining the intended extent of the indemnity being discussed, as well as stating precisely what is sought to be done economically, are critical[9]. Either they can get rid of the

[8]Ibid.

[9] Indemnity clauses in commercial contracts: how to achieve desired contractual risk allocation. (2011, June 7). Lexology.https://www.lexology.com/library/detail.aspx?g=db38e8d6-7451-49e19e74531bf32e0d10https://www.lexology.com/library/detail.aspx?g=db38e8d6-7451-49e1-9e74-

linear terms in ICA or they can make Section 124 a statute with specific future terms, but both of these alternatives will undermine the entire purpose of both ICA and Section 124. As a result, a common solution to address this hole must be established.

2. Problems with reciprocatory contracts

Although sections 124 and 125 make it clear that the indemnifier is completely committed to reimbursing the indemnity holder, the ICA's basic *"consideration"* condition requires that there be a "benefit to both parties." Consider the following scenario: A offers to buy B's house for Rs 50 lakhs. A profits in this scenario because he receives Rs 50 in return for his property, whereas B benefits because he obtains the home. According to Indian interpretation, the basis of a contract is that both parties benefit, yet section 125 only covers the rights of the indemnity holder, not the indemnifier[10]. After bringing together distant jigsaw pieces, we may form a holistic image that the indemnifier is not bound to reimburse for damages that are outside the scope of the agreement. The question of "*how the indemnifier benefits*" is, nevertheless, yet unaddressed.

How does the indemnifier gain from a loss when the deposits are only given to the loss bearer? Because a contract in which one party promises to pay a particular quantity to another party, such as a charity organisation, is not enforceable if there is no consideration[11], and if people are uninformed of this, they will refuse to become indemnifiers, causing the economic system to suffer.

3. Construction and Drafting problems:

Indemnity clauses can create a significant shift in a contract's (normal) risk distribution. As a result, courts have always treated indemnity clauses with care, subjecting them to "*very strict standards*." The justification for establishing such limitations on such clauses is the "*inherent possibility*" that the other party to a contract including such a provision intended to release the other from a liability that would otherwise fall to that party.

Liquor sales and prostitution are not illegal, but they are immoral if they include indemnity provisions to shield themselves from losses. If courts enable small contractors and suppliers to be free from the consequences of their own carelessness, they may be unable to negotiate a really equal risk distribution, and they may contradict public policy. Small contractors and suppliers may be helpless to negotiate a really equal risk distribution, and such regulations to

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[10] Gujarat Bottling Co Ltd V. Coca Cola Co. 5 SCC 545(1995)

[11] Jamuna Das v. Ram Kumar, AIR 1937 Pat 358: 169 IC 396

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fight overreaching may contravene public policy. A difficulty arises as a result of the careless drafting.

4. Privity to contract

"*Where all that shows is that a person transfers property to another and stipulates for the payment of money to a third person, a suit to enforce that stipulation by the third party will not lie*[12]*,"* according to Privity of consideration under section 2 (d). On the other side, the indemnity contract is all about receiving money from the indemnifier. So, in this scenario, there is a contract between two parties to save one from loss, but what if he causes the loss to a third person with whom he has a contract for something and the indemnifier at the same time? Who would compensate whom, why, and how would they do so?

All of these uncertainties must be resolved, because "the court might easily have permitted the plaintiff to recover the annuity, because consideration provided by any other person is just as effective." In Section 41 of the ICA, there is also a distinction to be made. What happens to the third party when there are three parties in general but only two parties are recognised by sections 124 and 125? What about his rights and responsibilities? In sections 124 and 125, all of these hazy regions are disregarded.

The (Nuns) were not hurt in one of the cases where the structure was destroyed. Because the building was removed at no cost to them, they really benefitted. The insurance payments were the Sisters' only chance for a benefit. The legal charge was only a formality because adequate insurance coverage would have mitigated the sisters' losses if the new convent had been damaged. Even the sisters may have been persuaded to set fire to the old convent if legally enforceable rights were the only requirement for insurable interest (or at least pray for fire[13]). This suggests that there are a number of holes to be plugged. As a result, a clause to safeguard third parties is essential.

5. Challenges arising out of fluctuations in market place

Under Section 73, "*discharge by breach,"* the difference between the contract price and the existing or market price at the time of breach is the measure of damages. Section124, on the other hand, simply evaluates the amount of real loss. Despite the fact that section 125 is dedicated to indemnity holder rights, the law ignores the fact that if the value of loss was estimated to be Rs 100 at the time of signing the indemnity contract, and the market price rose to 10,000 at the time when the loss actually occurred, there is a huge monetary value margin,

[12] Subbu Chetti b Arunachalam Chetty v. Selliammam Koil Coop Housing Society Ltd (2003) 1 ICC 184
[13] In Royal Insurance Co. V. Sisters of the Presentation, 7430 F2d 759 (9th Cir 1970). 68Id. at 760

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and just because the indemnifier is only liable to compensate for Rs 100, which was determined because the total value of goods was 100 at the time, the law ignores the fact that The statute did not take into account cost escalation or increased tax charges.

The borrower cannot impose or seek a set-off against the additional expected fees or interest that have been added to the money already provided for any damages. It makes no difference whether the insured has access to the structure for a few days because it has been condemned or because it has been sold. The insurer's duty for property loss indemnification begins the moment the loss occurs. Opening the issue of damages to proof that future circumstances may indicate the fire was helpful to the insured would be nothing more than conjecture and supposition because the amount of loss is decided at that time.

6. *Negligence on the part of indemnity holder*

A failure to take reasonable prudence by an indemnity bearer leads to the loss. This form of behaviour is known as contributory negligence. According to the ICA, regardless of whether a contract exists, the defendant's obligation in contract is the same as in the tort of negligence; the court has the jurisdiction to apportion fault and reduce the damages collected by the plaintiff, even if the claim is brought in contract. An agreement to indemnify implies a responsibility, regardless of the guilt of the indemnifier. The extent of such a duty is likewise "*uncertain and vague, and entirely in the hands of the indemnity bearer*[14]," according to the court. Indemnification imposes a "*special*" and "*extraordinary*" responsibility, similar to indemnification for one's own carelessness.

Contracting parties want a fair deal and have no incentive to breach it since their "*downside risks*" are covered. Breach isn't always unethical, and in certain cases, it's even promoted by "*efficient breach*" views. The argument against apportionment of strict contractual culpability is akin to the argument against allocation of liability for breach of fiduciary duty; apportionment would make the defendant's responsibilities less strict.

In *Criswell v. Seaman Body Corp.*[15]**,** a Wisconsin case, it was said that despite the fact that the owner had committed no wilful carelessness or fault, he was found liable to a subcontractor's employee for failing to comply with the Wisconsin Safe-Place Statute requirement to provide a "*safe place*" of work.

7. *Are there any exclusions for consequential or remote/indirect losses? Is there a connection between reasonability and foreseeability?*

[14] Jacobs Constructors, Inc. v. NPS Energy Services, Inc., 264 E3d 365 (3d Cir. 2001).
[15] 233 Wis. 606, 290 N.W. 177 (1940)

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The Contract Act only provides compensation for losses *"that the parties knew, at the time they entered the contract, were likely to come from the breach of it"* at the time of entering into the contract[16], which may be further characterised as the concept of contemplation of damages between the parties.

There is no such restriction in the context of an indemnity claim, as Lord Justice Staughton pointed out in the case of *Total Transport Corporation v. Arcadia Petroleum Limited*[17]. "Indemnity" can relate to any damage incurred as a result of a specific cause, whether or not it was in the parties' reasonable expectation. According to Section 124 of the Contract Act, an indemnity contract is *"a contract by which one party promises to rescue the other from loss caused to him by the promisor's action, or by the conduct of any other person[18]."* A claim for damages is subject to the same remoteness constraints as a claim for indemnity, but a claim for indemnification is not. Unless the indemnified party is clearly excluded in the indemnity contract, any consequential, distant, indirect, and third-party damages can be recovered by the indemnified party.

III. SUGGESTIONS

- According to the Law Commission's 13th report[19], the idea of an indemnity contract is not exhaustive. The proposals were to widen the definition of loss in section 124 to include examples of damage caused by incidents that may or may not be attributable to the conduct of any individual, as it only covers one form of indemnity and only describes a subset of the indemnity-rights. In addition, a section in the Chapter on Quasi-contracts should be included to explain situations when an obligation to indemnify might be derived from the law, and the rights in section 125, which are based on English law, should be defined more thoroughly. The remedies of an indemnity holder should be disclosed even if they have not been used.
- The question of "*how the indemnifier benefits*" is, nevertheless, yet unaddressed. The provisions should state more clearly that a quantity of money has been deposited with the indemnifier at a certain time period. The breadth and use of an indemnity will be largely influenced by how it is drafted and how well the wording reflects the parties' purpose.

[16] Section 73 of the Indian Contract Act, 1872
[17] [1998] 1 Lloyd's Rep. 351
[18] Indian Contract Act, 1872
[19] 13th report (Contracts Act) Law Commission of India (No. 13th). (1958). Law Commission Of India. https://lawcommissionofindia.nic.in/1-50/Report13.pdf

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Section 3- An implied contract is a legally binding obligation that emerges from the conduct, behaviour, or circumstances of one or more parties to a contract. It carries the same legal weight as an explicit contract, which is a contract entered into voluntarily and agreed upon verbally or in writing by two or more parties. The implicit contract, on the other hand, is presumed to exist but does not require written or verbal confirmation.

IV. CAN SECTION 124 BE EXPRESSED OR IMPLIED?

There is considerable disagreement, but there is also a lack of clarity. They are covered, but only if court findings are made. The fact that we should not depend on court rulings is explicitly stated in the law. To deal with the indicated scenarios, a modification is also required. Furthermore, when two parties agree to perform services under a contract, implicit contractual indemnity arises. According to this theory, the obligor's formal contractual connection implies a responsibility on his part to carry out the contract without harming a third person or his property. As a result, if the oblige damaged a third-party during performance and the third-party sued, the oblige was entitled to indemnification as long as he did not contribute to the injury. The most perplexing development in the indemnification debate has been non-contractual implicit indemnity. Non-contractual implied indemnification was once thought to transfer the whole weight of loss to the partner tortfeasor who was regarded to be more culpable. When determining whether a claim to non-contractual implied indemnification exists, a court must consider the parties' relative culpability. This "*fault evaluation*" is maybe the most dramatic character. Rather than writing beneath each component, the author argues that fixing the ambiguities as a whole is the ideal option because each problem has a similar origin and a single cure: clarity in drafting and minimising ambiguity in presenting. The most perplexing has been non-contractual implied indemnification. In the *Sheffield Corporation case*, the law commission recommended that it makes no difference whether the person making the request is aware of the illegality in his title or has found it. As a result, they should be referred to as quasi-contractual, and the law should include a new section 72 (a).

V. CONCLUSION

There is a lack of clarity or a lazy or biased formulation of the indemnity contract as only dedicating two sections to it and to that only mentioning the rights of the indemnity holder and leaving the duties of the indemnity holder and rights of the indemnifier solely to the reader's interpretation clearly shows the need for a broader version or amendment to be introduced to ensure equity and justice for both parties rather than assisting the dominant one.

Indian contract indemnity law has deviated from English law in various areas and pursued its

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own route. Their commonalities, on the other hand, much outnumber their differences. More than a century after the Act, the amount of consistency is very astounding.

A simple indemnification clause can never resolve a liability issue. Those who try to avoid taking responsibility for their conduct or seek exemption from culpability will find that the law is not on their side. The basic idea is that a negligent party cannot transfer all claims and damages against him to a non-negligent part.

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