A THREE-WAY UNDERSTANDING: CONTRACT OF INDEMNITY AND PERILS OF STATUTORY-JUDICIAL STALEMATE

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ABSTRACT

The "Contract of Indemnity" is one of the most important and highly invoked instruments among the mercantile fraternity, not only in India but globally as well. However, the statutory ambit of the same is covered under only two provisions of the Indian Contract Act (1872) i.e., under Section 124 which provides the definition, and Section 125 which deals with the rights of indemnity holder. The express provisions only deal with certain elements and do not cover the merit of the instrument as a whole, hence requiring judicial intervention. The judicial interpretation till now has filled the placid gap but often tended to ferry away from the contours envisioned by the statutory provisions. This paper discusses these impasses and tried to provide logical justification for the same.

Keywords: Contract, Indemnity, Indemnity Holder, Indemnifier, Promisor, Promisee.

INTRODUCTION

"The term 'indemnity' has a broad definition and can be used in a variety of situations any agreement in which one side is guaranteed not to lose money"[1]. A contract of Indemnity dictates an agreement when a person assures another person to save him from loss caused to him. The meaning of the expression "loss caused" to him can be attributed in two ways – first, by the act of the promisor himself or by an act of some other person/party. Also, it requires, like any other contract, the presence of two parties – the Indemnifier, who makes a promise to make good the loss caused to another party, and the Indemnity-holder, whose loss is made good. The terms promisor and promisee both appear in Section 124 and Section 125 respectively. The point of highlight is not the contract but the promise which inculcated the contract. In other words, a contract of indemnity can be equivalent to an indemnity promise, which is one of the factors of a much larger subject matter. The fine line between the two which the Indian judiciary is still not able to outline. Hence, a differentiation needs to be made. The variant of an Indemnity contract can be divided into two – wherein the goal of the

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[1] *A. Krishnaswami Iyer v. ThathaRaghaviahChetti*, AIR [1928] Mad 43

promisor is to protect the promisee from any threat, and second for fulfilling the compensation which apparently is not the end objective of the contract. There are certain essentials that need to be fulfilled in order for a contract of indemnity to stand – One is a promise between two parties which should be expressed promise[2] (it cannot be an implied promise). Two, protection against loss i.e., a promise should be made in order to protect the other party from incurring loss caused to him. Third, a loss may be caused by the promisor himself or by any other person and does not include loss caused by natural reasons beyond the excerpt of human control. Contracts of Insurance are not indemnity contracts under Indian law.

FINDINGS AND ANALYSIS

The legal verbosity used in Section 124 of the Indian Contract Act (1862) limits the scope and presents a narrower version of the term Indemnity as compared to the English Common law[3]. When read in consonance with Section 125, it does not specify or articulate where the action had been taken against the indemnified party. Section 124 speaks "A contract in which one party pledges to rescue the other party from damage caused by the guarantor's own activity or the action of any other person" – the contract is always based on two party's common consensus – one party saying something and the other party giving consent for the same meaning and same sense conveyed. But the verbosity suggested in Section 124 is limited to only one party specifying a limited responsibility. The meaning of loss is ambiguous, and the extent of recovery word is also not clear, hence the liability has become "absolute, clear and certain". Accidents caused or induced even by the carelessness of the promisee are to be subjected under the contract of Indemnity, even if there is no existence of a specific agreement of indemnification in place. "It is apparent from the preceding common law standards that one who is without blame and is compelled by law to defend himself against the act of another is entitled to indemnity."[4]The authority of enforceability of the promisee is not mentioned anywhere in the act. The ability to claim by Indemnification under English law was previously decided by the nature of the loss incurred. In Common law, the enforcement of the Contract relied upon the degree of the breach. And the breach in this case would only have been substantiated if the party had really incurred an injury. Section 124

[2]*Parker vs Lewis* [1873] LR 8 Ch 1035
[3]Wayne Courtney, *Indemnities and the Indian Contract Act 1872* <http://www.jstor.org/stable/44283647> accessed on 21st July 2023
[4]*Criswell v. Seaman Body Corp.*, 233 Wis. 606, 290 N.W. 177 [1940]. [9]*Secretary of State v. The Bank of India*, [1938] 40 BOMLR 868

only delivers express indemnity, which is quite contrary to the Indian scenario, wherein the Law Commission report called for "expressly and impliedly" if the promise made between two parties is valid and consistent with the law (factual case by case basis). Additionally, Section 145 relates to the principal debtor paying back the amount promised in regard to the surety. Section 124 when read with Section 125 suggests that the arrangement is made due to protect the third parties from any liabilities. It negates the damages as a result of natural events and focuses more on the action of individual or juristic persons. The eligible entity and potential party in respect of the Indemnifier are conceptually ambiguous.

In regard to the banking and financial percept, Indemnification is often associated with grantees. It brings a question of the impasse of whether third-party indemnification should be considered or not.

RIGHTS AND DUTIES OF INDEMNITY HOLDER

Rights of Indemnity holder, in lieu of the promise acting within the scope of his authority, the person is entitled to recover from the promisor – First, all damages which the person was compelled to pay for any suit in respect of matters to where the promise of indemnity applies Second all costs if in bringing/defending such suit, the person did not contravene the orders of the promisor, in the absence of any indemnity, for him to act[5]. Third, all sums that the person might have paid under the terms of any compromise of such suit if the promisor authorized him to compromise the suit. In *Bihal Chandra vs Chatur Sen*[6], where the seller promised to the purchaser to indemnify him against any dues, the court held that such an indemnity clause would include only existing or current due and not those retrospectively imposed. The duties of the Indemnity Holder is corollary is the Right of the Indemnifier, which includes –To act in accordance with the order of the indemnifier[7], acting as a man of ordinary prudence, and bringing all the material facts to the knowledge of the Indemnifier. *Osman Jamal & Sons Ltd vs Gopal Purushottam*[8]held that indemnity is not necessarily given by repayment offer payment. Indemnity requires that the party to be indemnified shall never be called upon to pay.

[5]*Gopal Singh vs Bhawani Prasad* [1888] ILR 10 AII 531
[6]AIR [1967] AII 506
[7]*Nallappa vs Virdhachala Reddi* [1914] 37 Mad 270
[8][1928] ILR 56 Cal

CAUSE OF ACTION AND PERIOD OF LIMITATION

It was held that the essence of the contract in its true construction, in a contract of indemnity had two causes of action It was permissible for the plaintiff to call upon the defendant to pay the amounts claimed in the order of the Sales Tax Officer directly to the authorities. It was also permissible for the plaintiff to wait till he suffers a loss i.e. When he actually paid the amount of the claim. The suit will lie within the period of Three years under Article 113 of the Limitation Act from the date of payment. [9]

SCOPE AND LIMITATIONS

Section 125 only expressly talks about the rights of the person who is being indemnified in a situation if he/she is being sued. High Courts have a wide variety of opinions of what an indemnity-holder can do – for e.g., Bombay High Court's Justice Chagla has opined that no action can be sought under English Common Law unless there is an actual loss. In equity parlance, if the person holds liability and if money is not yet lost, they can still file a lawsuit. Indemnification does not simply attribute itself to paying back the money owed; it also means protecting someone from losing money. This is what the Court of England had reiterated to make up things easier for the common law to adhere to. Calcutta HC held that the indemnifier should pay the amount of the lost property as provided by the surveyor. Any settlement for lesser value is arbitrary and unfair and violates the Right to Equality in the Indian Constitution[10]. The Sheffield principle covers various types of indemnity to be paid out – two obvious choices, from a debtor to a surety, principal to agent. However, the Sheffield principle covers a broad aspect – an insurance agent does not cover every aspect during the course of the job. Property owners are not to be protected from every other loss or liability when the master does when the person does if hired. English common law, however commonly perceives that the terms are contractual but there are a lot of different ideas. Bombay High Court observed that the contract of indemnity holds little value if the promise could not enforce his/her indemnity and consequently he actually pays for the loss incurred.[11]

[9] *Abdul Hussain Jambawalla vs Bombay Metal Syndicate*, AIR [1972] Bom 252
[10] *Mohit Kumar Sahavs vs New India Assurance Co* AIR [1997] Calcutta HC
[11] *Gajanan Moreshwar vs Moreshwar Madan*, [1942] 44 BOMLR 703

CONCLUSION& SUGGESTION

It can conclusively be said that while the indemnification provision of the Indian Contract Act is a well-accepted norm, it falls short in various segments when studied in coherence with the Indian legislation of the Indian Contract Act. The legislation only focuses on a singular type of compensation and utterly overshadows to answer what the judiciary ought to do in a variant form of situation, where various types of indemnities e.g., those as an outcome of natural occurrences, in such a scenario the law fails to ponder. In terms of defining and assignment of entitlements to the promise, the Indian law nullifies the very nexus of the theory of indemnification – indemnity cannot be claimed by any individual unless he actually incurs an injury. This ties the hand of the judiciary and incapacitates the promisee who is incapable of recovering the loss of his/her own.