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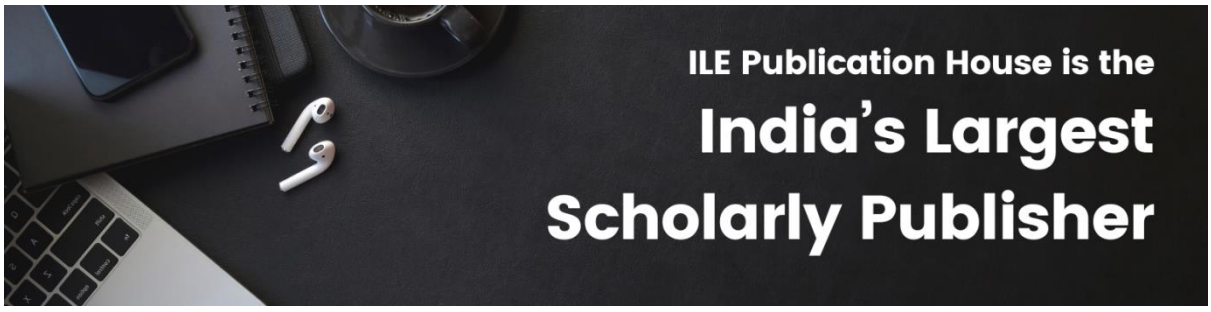

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CRITICAL ANALYSIS OF THE LAW OF INDEMNITY UNDER SECTION 124 AND SECTION 125 OF THE INDIAN CONTRACT ACT, 1872

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INTRODUCTION

A contract entered into between two parties in which **one promises to shield the other from loss** is known **as an indemnification contract**.[2676] In these contracts, the party receiving the protection is referred to as the indemnity-holder or the indemnified, while the party saving from such damage is referred to as the indemnifier. The law of indemnity is enshrined in ***Section 124*** and ***Section 125*** of the **Indian Contract Act, 1872**[2677]. Such contracts are typically included in a clause with another instrument rather than being utilized individually. The Indian Contract Act of 1872 limits the scope by specifying the 'contract of indemnification' instead of 'promise of indemnity'. 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.

[2676] https://www.ijlmh.com/paper/identifying-the-gaps-issues-and-shortcomings-in-section-124-and-section-125-of-the-indian-contract-act-1872-and-recommending-solutions-to-fill-the-gaps-and-shortcomings/

[2677] The Indian Contract Act, Act No.9, Imperial Legislative Council, (1872).

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ESSENTIALS OF A CONTRACT OF INDEMNITY

Before delving into the shortcomings of the statutory provisions, it is worth enlisting some essentials of a contract of indemnity.

- There must be a loss according to terms of the contract.
- The contract must satisfy all conditions given under ***Section 10*** of the Indian Contract Act.[2678]
- The loss must be caused either by the conduct of the promisor or by any other person. It is thus, limited to loss caused by human agency.
- There are two parties to the contract: indemnity-holder and the indemnifier.
- The object and consideration for the contract should be lawful.
- The contract must be contingent in nature, as it is enforceable only when a loss occurs.

A contract of indemnity may either be express (i.e. made by words spoken or written) or implied (i.e. inferred from the conduct of the parties or circumstances of the particular case)

CRITICAL ANALYSIS AND SUGGESTIONS

SECTION 124

1. **THERE ARE ONLY TWO PROVISIONS CONCERNING INDEMNITY:** The law of indemnity is not codified adequately. It majorly relies on the common law system, and the principles of Justice, Equity and Good Conscience.
2. **RESTRICTS TO TWO PARTIES ONLY:** The definition merely covers losses resulting from the conduct of a promisor or any other person, as further interpreted in ***Punjab National Bank VS Vikram Cotton Mills***[2679].
3. **NO EXCEPTIONS TO ACT OF GOD:** In comparison to Indian law, the English definition of indemnification is broader since it safeguards the indemnity holder against damage resulting from any cause, whether by human agency or by mishaps like fires, floods, earthquakes, etc.[2680] All insurance contracts, with the exception of life insurance, are indemnity contracts under English law. The definition of "indemnity" in the ICA is limited since it only applies to "loss" that is brought about by a human agency under one of two circumstances: either by the promisor's own actions or by the actions of any third party.

The landmark case, ***Adamson v Jarvis***, falls outside the ambit of *Section 124*. Jarvis directed Adamson auction certain cattle that actually did not belong to him, and when the real owner claimed ownership, Adamson had to pay the damages. The Court ordered Jarvis e to indemnify Adamson for the losses incurred.[2681]

The landmark case of ***Gajanan Moreshwar Parelkar vs. Moreshwar Madan Mantri*** established that a liability on the indemnity-holder that is certain and absolute would obligate the indemnifier to clear it off. [2682] ***New India Assurance Company Ltd. Vs Kusumanchi Kameshwra Rao & Others***[2683], also negates losses caused by external factors.

4. **SILENT ON OVERSIGHT OF DEFAULT:** The definition does not encapsulate what happens if there is oversight of default.
5. **CASE OF IMPLIED INDEMNITY:** An indemnity contract may be express or implied, but *Section 124* does not appear to cover the latter scenario. Yet, the judiciary has taken a rather holistic view in cases like The ***Secretary of State vs. The Bank of India Limited***, wherein, the court decided that an implicit indemnification existed in order to promote equity and justice[2684]. Special circumstances of implied indemnity are addressed in *Sections 69, 145* and *222* of the Act. Implied indemnity goes near the

[2678] The Indian Contract Act, Act No.9, Imperial Legislative Council, (1872).
[2679] 1970 AIR 1973.
[2680] Swarna Mullick, Assessing the Gaps, Problems, and Shortcomings in Sections 124 and 125 of the Indian Contract Act of 1872 and Recommending Remedies to Address the Gaps and Shortcomings, 5 International Journal of Management and Human Resources, 1963 (2022).
[2681] 1827 4 BING 66.
[2682] (1942) 44 BOMLR 703.
[2683] (1997) 9 S.C.C. 179.
[2684] AIR 1938 PC 191 (193).

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boundaries of Equity[2685]. Thus, there is textual confinement of the law of indemnity. The phrase *"you must be damnified before you can claim to be indemnified"* refers to both express and implied treaties of indemnification under English law. ***Shankar Nimbaji vs. Laxman Sapdu*** upheld this premise as well.[2686]

The principle that the indemnity holder can require the indemnifier to make good on a loss when liability of the indemnity holder becomes clear was upheld by the Allahabad High Court in ***Shiam Lal vs Abdul Salam*** [2687]", the Madras High Court in ***Ramalingathudayar vs Unnamalai Achi***[2688], and the Patna High Court in ***Chunnibhai Patel vs Natha Bhai Patel***[2689]. The **Law Commission in 1958** in its **13th Report** suggested that *Section 124* of the Indian Contract Act, which defines indemnity, be amended to include the words that describe the express and implied nature of indemnity as well as indemnification emanating from actions of objects other than third parties.[2690]

SECTION 125

6. **PRINCIPLE OF SUBROGATION NOT MENTIONED:** The principle of Subrogation is founded on Equity. It refers to a situation wherein a third party assumes another party's legal right to collect a debt or damages. It is a crucial aspect of indemnification law, but is not mentioned anywhere in this definition.
7. **RIGHTS OF INDEMNIFIER NOT GIVEN:** *Section 125* merely provides for the rights of the indemnity-holder, but does not do the same for the indemnifier. Despite the fact that a contract is bidirectional in nature, the law only describes the rights and obligations of the indemnity-holder.[2691] By not providing equal weight to both parties to a contract, the law goes against the ideals of justice and fairness that the law generally seeks to promote.
8. **RIGHTS WHEN AVAILABLE?** Perhaps, the biggest shortcoming of the law of indemnity is that *Section 125* gives an impression that the rights of indemnity-holder can only be availed when sued in court. However, this is still a grey area of research. The rights and duties of the indemnifier seem to be correlated with those of the indemnity-holder. Use of words such as "compelled" "have paid"/ "recover" reflect a meaning contrary to that of "saving" and hence frustrate the very rationale of indemnity, as the definition is closer to reimbursement.

   There is superfluity in the language of *Section 125(2)* and *(3)* with respect to the "scope of authority". If the promisor acts within the scope of his authority, the promisee has the right to sue the promisor. The contract will be voidable at the discretion of the party whose consent was coerced, fraudulently obtained, or obtained via deception.
9. **COMMENCEMENT OF LIABILITY OF INDEMNIFIER:** The idea of "damnification" serves as another component of the puzzle. It can be important to determine when a possible loss turns into a real loss. [2692]The definition contains an inherent contradiction – should the indemnifier "save" before the loss occurs, or "reimburse" after the loss occurs? Legislations that contain words such as "save/protection" reflect a protective mechanism, but in this definition, it is unclear whether it is protective or curative. The Act does not contain details on the commencement of the indemnifier's liabilities, but judicial pronouncements such as ***Khetarpal Amarnath v. Madhukar Pictures*** [2693] state that the liability of an

[2685] The Indian Contract Act, Act No.9, Imperial Legislative Council, (1872).
[2686] 1940 42 BOMLR 175.
[2687] AIR 1956 Bom 106.
[2688] AIR 1914 Mad 655 (D).
[2689] (1936) 38 BOMLR 175.
[2690] Law Commission of India, 13th Report on The Indian Contract (Amendment) Bill, 1992, (Dec, 1994).
[2691] Swarna Mullick, Assessing the Gaps, Problems, and Shortcomings in Sections 124 and 125 of the Indian Contract Act of 1872 and Recommending Remedies to Address the Gaps and Shortcomings, 5 International Journal of Management and Human Resources, 1963 (2022).
[2692] Aditya Kashyap, Critical Analysis of Contract of Indemnity, 3 Nyaayshastra L. REV. 1 (2022).
[2693] AIR 1956 Bom 106.

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indemnifier begins when the liability of the indemnity-holder becomes certain and absolute. In ***Nallappa Reddi v. Virdhachala Reddi***[2694] and ***Oriental Insurance v. Praful Kumar Mohanty***[2695], this premise was upheld.

10. **NATURE OF LOSS NOT SPECIFIED:** A close reading of *Section 124* and *Section 125* together gives an impression that the "loss" is merely monetary in nature since words such as "damages, costs and sums" have been used. This further highlights the narrow scope of these sections. In *Section 124*, instead of the word "save", "reimburse" or "compensate" should have been used in the context of a curative mechanism. Alternatively, "save" should have been followed by "loss likely to be caused" so that it goes close to the boundaries of a preventive mechanism.

CONCLUSION

Indemnity, being one important type of Special Contract, is codified under *Sections 124* and *125* in the Indian Contract Act, 1872. Considering its significance in the world of commerce, it is surprising to note that several anomalies are inherent in its definition, giving rise to a large grey area of research. This paper has enumerated these anomalies along with case laws to substantiate them and has also given recommendations to address them – these range from suggestions with respect to drafting inadequacies to a wider interpretation of judicial pronouncements in order to broaden the scope of indemnity under Indian Law.

While creating an indemnity agreement, it is crucial for the party providing the indemnification to set a limit as these are significant defenses against potential financial outlays and have thus developed into a key component of business law.

Due regard certainly has to be paid to the acumen of judges to creatively interpret the law of indemnity in a wider dimension. For several years, the law of indemnity has been the subject matter of research and the evolution of this concept has been more or less settled now. Yet, further creativity on the part of the Judiciary to go beyond the letters of law is necessary to engage with its spirit and attribute true meaning to the law of indemnity and justify its rationale.

[2694] (1914) 37 Mad 270.
[2695] (1997) AIHC 2822 (Ori).