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Analyzing Issues, Gaps And Flaws In Sections 124 And 125 Of The Indian Contract Act, 1872, And Providing Solutions

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Abstract

As with the promise of indemnity, an indemnification contract has a far greater scope than a simple promise of indemnity. Section 124 of the 1872 Indian Contract Act focuses solely on one type of reimbursement and completely fails to coordinate what the judge should focus on in situations in which different types of indemnities, such as those resulting from events like disasters, do not contain the implicit form of indemnity. Unless the promisee has really been harmed, he or she is not entitled to compensation under Indian law. An indemnified party may only seek compensation after the contract has been broken, which goes against the basic premise of indemnity. For both the promisee and the courts, the inability to compensate for losses on one's own causes a significant problem. Because of the discrepancy between the indemnity contract and the promise to indemnify, this has caused misunderstanding in the legal system.

KEYWORDS: *Indemnity, Contract, Promise, Damages*

Problems, Shortcomings, Or Issues Concerning Contract Of Indemnity Under Indian Contract Act, 1872

Introduction

In the present paper, the researcher talks about the loopholes that are being present in Section 124 and 125 of the Indian Contract Act, 1872. There are some important issues that are not expressly addressed in the statutory framework under the Indian Contract Act 1872 comprised of only two sections. In addition to that, judicial interpretation and further evolution of the law of indemnity give us an impression of little departure from the statutory language used in these two sections. The law of indemnity has been studied and discussed in various case laws interpreting its legality and present state under the Indian Contract Act 1872. While analyzing the law of indemnity, it has always taken a direction where the same is compared to English law of indemnity and how some relevant and necessary changes are a must under Indian law of indemnity.

In light of the above research problem, the following are the problems that could be regarded as the loopholes in the existing Indemnity contract provision:

- **Definition Clause Incomplete:** Indemnification is the one party's contractual responsibility to pay the other party for losses or damages that have happened or may arise in the future as a result of his or another party's actions. Section 124 of the Indian Contract Act, 1872 defines the term 'indemnity' as "*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.*"¹ But what can be inferred from the present definition is that Section 124's definition is, in some ways, incomplete. A contract is bilateral in nature, yet the definition only accounts for one party's responsibilities, and even then, only for one form of duty. In a more precise meaning, the term "contract of

¹ The Indian Contract Act 1872, Section 124, Acts of Parliament (India).

indemnification" is often used in English courts to denote a contract in which one party's only, or only major, the executory obligation is to indemnify another.²

- **Negligence:** Whether the indemnification agreements protect the owner if the accident was caused or contributed to by the negligence of its employees. According to the law, any indemnity agreement will provide compensation where the damages are solely the result of the contractor's mistake or carelessness.³ If the owner is found to be accountable as a consequence of the accident, most countries have a common law right to indemnity that applies even if no explicit indemnification agreement exists. "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."
- **Third Parties:** In banking or financial products, indemnification promises are frequently paired with guarantees. The issue of enforcement has grown increasingly difficult: can an indemnity be enforced to safeguard third parties? How do common law restrictions on remoteness or harm mitigation influence indemnity claims? It is also likely that our understanding of contractual structure and scope has evolved significantly.
- **Eliminates Damages Caused by Natural Occurrences:** Section 124 contemplates a far smaller range of indemnities than the English common law notion of indemnity. When read in connection with Section 125, which handles actions against the insured party, it appears that the primary issue was with pledges to protect third parties against claims or liabilities.⁴ The focus on the conduct of natural or juristic individuals eliminates damages caused by natural occurrences, which are frequently the topic of indemnity insurance policies. It is theoretically messy to limit the relevant actor to the promisor or a third party.
- **No Mention of Enforcement of Indemnity:** It's odd that the Act makes no mention of the promisee's ability to enforce the indemnification. The Act went into force long before England's administration of law and equity was merged. The nature of the damage determined an indemnified party's action to enforce the indemnity under English law at the time. It could be laid down that at common law, enforcement was

² Satish Padhi, Ruchir Sinha & Vyapak Desai, Revisiting The Indemnity V/S Damages Debate, NDA, 2, (2017), https://www.nishithdesai.com/fileadmin/user_upload/pdfs/NDA%20Hotline/Deal-Destination-Revisiting_the_Indemnity_vs_Damages_Debate.pdf

³ Ibid

⁴ The Indian Contract Act, Section 125, Acts of Parliament, 1872 (India).

often accomplished by demand for damages for violation of the contract.⁵ The contract would only be breached if the indemnified party really suffered damage; at that time, the indemnifier had, by definition, failed to hold the indemnified party harmless from loss.

- **Covers Express Promises of Indemnity:** Another restriction raised is that Section 124 of the Act only applies to express guarantees of indemnification. Whether or whether such interpretive gloss is valid, implicit indemnities have been routinely recognized in Indian law. In that regard, the Law Commission's suggestion in Section 124 to include the words "expressly or impliedly" after "promises" is reasonable and consistent with case law. Section 145⁶, on the other hand, expressly refers to an implicit pledge by a primary debtor to compensate the surety.⁷
- **Section 125 Interpretation:** In an indemnity contract, the promisee has the right to recover from the promiser if he acts within the limits of his power:⁸

(1) all possible harms that he might be expected to pay in any case emerging out of any make a difference to which the promise to reimburse relates;

(2) all costs which he might be obliged to pay in any such case if, in bringing or safeguarding it, he didn't penetrate the promiser's orders and gone about as it would have been fitting for him to act without a trace of repayment contract, or then again assuming that the promiser approved him to document or shield the matter;

(3) any installments paid under the situations of any compromise of any such prosecution, given that such compromise was not in opposition to the orders of the promiser and was one which the promisee would have made without any agreement of repayment, or on the other hand in the event that the promiser approved him to think twice about the issue.

From the language of Section 125, it could be determined that the opening lines of Section 125, as well as an internal cross-reference to 'any such suit' in Section 125(3), favor the earlier interpretation. Strictly speaking, Section 125(3) applies only when an action is filed, not when a settlement is reached beforehand. However, it has been agreed that the indemnifier may still be obligated in the latter case. It also appears that Indian courts have adopted a further modification that is not expressly stated in Section 125(3): if the indemnified party provides

⁵ Ibid.

⁶ The Indian Contract Act 1872, Section 145, Acts of Parliament (India).

⁷ Burhan, Indian Law of Indemnity and English Law of Indemnity: An Analysis, LEGAL SERVICES INDIA, (Apr. 14, 2022, 4:57 PM), <https://www.legalserviceindia.com/legal/article-5725-indian-law-of-indemnity-and-english-law-of-indemnity-an-analysis.html>

⁸ Ibid.

due notice of the claim or action and the indemnifier declines to intervene, the indemnifier is barred from claiming that the compromise was unwise.⁹

Suggestions To Fill The Gaps Present In Indian Contract Act Regarding Indemnity Clauses

From the identification of different issues that have been addressed in the above section, it could be laid down that during the drafting of business contracts, indemnity provisions are heavily argued and focused on. A badly worded indemnification clause might have serious implications. But the underlying question is whether there is any cause to seek indemnification rather than pursuing statutory damages under the Indian Contract Act of 1872, which is already available under the law. Is indemnification merely an agreement to cover a party's damages? Is it possible to restrict damages in a contract? What is the difference between liquidated damages and indemnity? Certain other questions arise in regard to the clause of indemnity provided under Indian law.

While interpreting indemnity terms in *Gajanan Moreshwar Parelkar v. Moreshwar Madan Mantri (1942) 44 BOMLR 703*, the Bombay High Court said unequivocally that the Contract Act is not exhaustive and that common law rules must be used.¹⁰ Subsequently, except if there is a conflict with the Contract Act or any legal choices given by Indian courts, custom-based regulation principles applicable to contract understanding will keep on applying to indemnifying provisions.

To begin, it is critical to clarify whether common law concepts apply when reading indemnification provisions, or whether the Contract Act is self-sufficient and exhaustive.

- a. A simple indemnity provision can never address a liability concern. Those who try to avoid accountability or seek to absolve themselves of responsibility for their conduct will find the law unfriendly. The basic idea is that a negligent party should not be allowed to shift all claims and damages against him to a non-negligent party.¹¹
- b. An indemnity contract is one sort of contract. The standards that apply to contracts, in general, apply to such transactions as well, thus laws like free permission or assent, the legality of the object, and so on are equally significant. As in the case of general

⁹ Ibid.

¹⁰ *Gajanan Moreshwar Parelkar v. Moreshwar Madan Mantri (1942) 44 BOMLR 703*

¹¹ *Sambhav Purohit and Aayushi Bhatti*, Contract of indemnity and loopholes, Ipleaders, (Apr. 14, 2022, 6:00 PM), <https://blog.ipleaders.in/contract-of-indemnity-and-loopholes/>

agreements, permission to an agreement should not be obtained via duress, fraud, or deception; otherwise, the contract will be voidable at the choice of the party whose consent was obtained in this manner; the same holds true for contracts of indemnification. The Contract Act requires that the element or goal of the agreement be valid.

- c. Furthermore, the Law Commission believes that the Indian Law of Indemnity, as defined in Section 124 of the Indian Contract Act, is insufficient because it does not define the various aspects of indemnity. The same was said about Section 125 of the Act, where the Indian Law, once again, falls short in addressing the rights of the promisee. The courts frequently have to depend on Indian common law, which is equivalent to English law in this regard.¹²
- d. The commission further claims that Section 125 of the Act is deficient since the rights of a promisee as described in this Section do not encompass all of the rights that the promisee holds. A few courts and judges have agreed that the promisee can use his right to indemnification and be relieved of all responsibilities imposed by the promisor even though he has experienced actual loss, while others have disagreed. The Law Commission, on the other hand, agrees with the stated viewpoint. The courts that accepted the perspective followed English Law of Indemnity, and the Commission referenced the following to better elucidate the notion.
- e. The Commission believes that the term mentioned in Section 124 of the Indian Contract Act should be improved and updated so that it encompasses various types of indemnity such as losses caused by natural phenomena, accidents, and so on, as well as implicit indemnity as a concept.
- f. In its 13th report, the Law Commission of India acknowledged and expounded on each of the aforementioned issues before proposing a modification to the Indian Contract Act of 1872.¹³ The Commission suggests that in Section 124, which defines indemnity, the phrases that describe both the express and implicit nature of indemnity, as well as the indemnification that comes from the behavior of items other than third parties, be included.

¹² Ibid.

¹³ Law Commission of India, Thirteenth Report, 1872

- g. The Law Commission even proposes an entirely new Section 72(A) that places indemnification under quasi-contracts.¹⁴
- h. The Law Commission has mentioned a 'implied contract' of indemnity in its Report. Although an implied guarantee of indemnification may exist in an implied contract, it is critical to understand that the two notions are separate.
- i. Finally, it advises that Section 125 be amended to contain the required language stating the promisor's obligation, which does not simply emerge when the promisee suffers damage.
- j. According to several recommendations of the Indian Law Commission, insertion of various new terms into the contract of indemnification under sections 124 and 125 of the Indian Contract Act have been suggested in order to broaden the scope of the act and make it more comprehensive and dominating. In several areas, Indian law on contractual indemnities deviates from English law and follows its own path. Their similarities, however, significantly outnumber their differences.¹⁵

What can be laid down from the interpretation of the clause of indemnity is that the Indian Law has gaps in its legislation about the genuine meaning of indemnification. However, these loopholes are being rectified in accordance with the necessities via jurisprudence and judicial hearings.

Reports such as the Law Commission Report are vital for contributing to the creation of legal concepts and the improvement of existing ones.

The English Law and its rules should be enforced by Indian courts, but not so much that they are fully affected by them. Indemnities are a necessary component of every contract lawyer's toolset, and they are frequently a contentious portion of a contract discussion. The legislation governing indemnities is complicated and, in many circumstances, unresolved.¹⁶ Ensuring that you have a thorough knowledge of the principles and are aware of potential hazards will assist you in identifying contractual risks and, where feasible, mitigating them from the start.

¹⁴ Ibid.

¹⁵ Osborne Clarke, Spotlight on contractual indemnities, Insights, (Apr.14, 2022, 9:00 PM), <https://www.osborneclarke.com/insights/spotlight-on-contractual-indemnities>

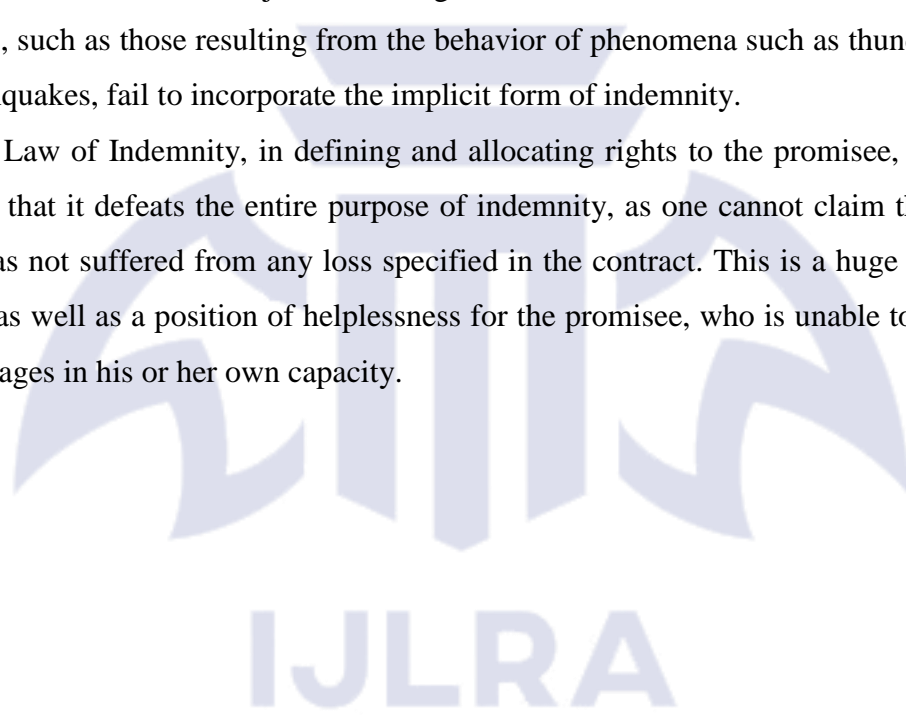
¹⁶ Wayne Courtney, Indemnities And The Indian Contract Act 1872, Vol.27, NLSIR, 2, (2015) <http://www.jstor.org/stable/44283647> Satish Padhi, Ruchir Sinha & Vyapak Desai

Conclusion

From the present research, it has been noticed by the researcher that the provision of indemnity is highly developed, yet it falls short in several areas where the legislation specified in the Indian Contract Act, 1872 leaves numerous holes in terms of the indemnity's qualities.

Moreover, Section 124 of the Indian Contract Act, 1872, which characterizes what an indemnity implies under the Indian regulation just spotlights on one kind of reimbursement and neglects to coordinate what the judicature ought to focus on situations where different sorts of indemnities, such as those resulting from the behavior of phenomena such as thunder causing a fire or earthquakes, fail to incorporate the implicit form of indemnity.

The Indian Law of Indemnity, in defining and allocating rights to the promisee, falls short in such a way that it defeats the entire purpose of indemnity, as one cannot claim the indemnity until one has not suffered from any loss specified in the contract. This is a huge quandary for the courts, as well as a position of helplessness for the promisee, who is unable to compensate for the damages in his or her own capacity.



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