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Loopholes in Section 124 and Section 125 of the Indian Contracts Act

Authored By-Siya Sharma

Introduction

Indemnity, in everyday language, means protection from loss or damage. It is the responsibility of a person to compensate another person for a specific loss they have sustained. The person or entity who makes the promise is called the 'Indemnifier', and the person or entity to whom the promise passes refers to as the 'Indemnified' or 'Indemnity Holder.'

English Law defines Indemnity as a promise to protect a person from the consequences of an action. Such a promise may be explicit or inferred from the facts of the situation.¹

In common law, *Adamson V. Jarvis* (1872)² was the case which established indemnity; Adamson was an auctioneer instructed to sell cattle and goods by Jarvis. Jarvis was the principal to whom the owner handed over the cattle. However, Adamson was under the impression that Jarvis owned the cattle and the goods. Further, the actual owner held Adamson liable for conversion and was successful in his case. Adamson had to pay damages and, in turn, sued Jarvis to indemnify him for the losses he suffered through damages to reimburse the actual owner.

The outcome of this lawsuit was that Jarvis had to compensate Adamson damages because there was a lack of disclosure about actual ownership. As a result, it concluded that the defendant was liable for the plaintiff's loss and must compensate him following Section 125 of the 2nd rule.

The Indian Contract Act, 1872, Section 124 defines Indemnity as a contract by which one party promises to save the other from loss caused to him by the promisor himself or by the conduct of any other person.³

¹ Burhan, "Indian Law of Indemnity and English Law of Indemnity: An Analysis" (*Legal Service India - Law, Lawyers and Legal Resources*)

² ADAMSON V. JARVIS (1827) 4 BING.66:29 R.R 503

³ Indian Contracts Act, 1872, s 124

The scope of Indemnity in section 124 of the Indian Contracts Act is much narrower than the common law's understanding of the contract of Indemnity.⁴ When the act is read alongside section 125, which talks about the promisee's rights, it appears that the promise to indemnify against a third party's claims or liabilities was the primary source of concern. The majority of published English cases, even in the late 1800s, dealt with indemnities in this broad sense or, more specifically, indemnities resulting from a promisor's violation of contract, which led to a claim being made by a third party against the promisee. An example of this can be found in *Harburg India Rubber Comb Co. v. Martin*⁵.

It has been noted that there are several issues and loopholes which are not mentioned in the two sections of Indemnity under the Indian contract Act. Furthermore, with the passage of time and development, it has been witnessed that certain loopholes within the law have been felt over time.

Concerning the above problems, there are certain loopholes which can be witnessed in section 124 and section 125 of the Indian Contract Act

1. The definition of Indemnity in section 124 is *incomplete* in some sense. The definition only includes the contractual obligation of one party to reimburse the other party for losses and damages that have already occurred or could occur due to their actions or the actions of a third party. However, a contract is bilateral and more complex, and this definition only accounts for one party's responsibility and, more so, just one type of obligation.
2. Section 124 does not include losses brought about by mishaps or circumstances unrelated to the promisors or any other person's actions. The question is whether the owner is protected if the employee's negligence caused the accident. According to the law, any indemnity agreement will provide compensation where the damages are solely the result of the contractor's mistake or carelessness. Suppose the owner is found to be accountable because of the accident. In that case, most countries have a common law right to Indemnity that applies even if no explicit indemnification agreement exists, in *Criswell V. Seaman Body Corp.*⁶ the owner was ruled liable to

⁴ Wayne Courtney, 'Indemnities and the Indian Contract Act 1872' (2015) 27 Nat'l L Sch India Rev 66

⁵ CA 1902

⁶ *Criswell v. Seaman Body Corp.*, 233 Wis. 606 (1940)

a subcontractor's employee for failing to uphold the duty to provide a "safe place" of employment under the Wisconsin Safe-Place Statute, even though there was no wilful negligence or wrongdoing on his side.⁷

3. Very little is said about the enforcement of contracts by the promisee except for concerning lawsuits and compromises. There is no mention of fair enforcement or punishments.⁸ Long before England's legal and equitable system was consolidated, the act of Indemnity was passed. The nature of the damage determined whether an indemnified party was entitled to the Indemnity under English Law at the time. It may be said that in common law, a claim for damages for contract violation was regularly used to enforce contracts. The indemnifier had worked to secure the indemnified party from loss by definition; the agreement would only be terminated if the indemnified party suffered harm. 'In *Gajanan Moreshwar v. Moreshwar Madan*⁹. In this historic judgement, the court said, "The Indian Contract Act is both amending as well as consolidating Act and is not exhaustive of the law of contract to be applied by the courts in India". In this case, the court rejected the defendant's argument that the plaintiff had no loss and could not make a claim. According to the court, the indemnity holder may ask the indemnifier to take care of a liability if it has been incurred and is absolute. As a result, the defendant compensated the plaintiff for all obligations under the mortgage and deed of additional costs.¹⁰ The court held that Section 124 of the Indian Contract Act does not apply to those classes of cases where the Indemnity arises from loss caused by events or accidents that do not or may not depend upon the conditions but only to one specific kind of Indemnity that arises from a promise made by the indemnifier to protect the indemnified from loss caused to him by the conduct of the indemnifier himself or by the conduct of any other person. It further explained that it was also mentioned that if the indemnified could not enforce his Indemnity until he had paid the loss, the Indemnity might not be worth very much at all. If a lawsuit was brought against him, he had to wait until the verdict was rendered, and only then could he bring an indemnification claim. In some cases, an unacceptable burden is placed on the indemnity holder. He might not be able to pay the judgement, but until he did, he could not use his Indemnity. Because of this, the Court of Equity intervened, tempered the effects of common law, and decided that if an

⁷ - DR and others, "Contract of Indemnity and Loopholes" (*iPleaders* August 16, 2021)

⁸ Wayne Courtney, Indemnities and the Indian Contract Act 1872, 27 NAT'L L. Sch. INDIA REV. 66 (2015).

⁹ (1942) 44 BOMLR 703

¹⁰ Top A and Tiwari S, "Contract of Indemnity Case Laws - IJSER" (*International Journal of Scientific Engineering and Research (IJSER)*)

indemnified party has incurred an absolute liability, he has the right to request that the indemnifier absolve him of that obligation and pay it.¹¹

4. Another issue in section 124 of the Indian Contract Act is that it only talks about contracts of Indemnity, which are expressed, or promises of Indemnity, which are expressed. However, in reality, implied indemnities are also accepted under Indian Law, and the Law Commission of India recommended these changes in its 13 Report, 1958 on the Indian Contract Act.¹² It is possible to infer implied Indemnity based on the parties' actions or the facts of the case. It was held in several cases that Indemnity could also develop by operation of law. Implied Indemnity was very well highlighted in the case of *Secretary Of State vs. The Bank of India*¹³. When a broker falsely signed off on a government promissory note. Acting in good faith, the bank requested and was granted a renewal of a promissory note from the Public Debt Office. The genuine owner filed a conversion lawsuit against the Secretary of State in the interim. As a result, the Secretary of State filed a lawsuit against the bank based on implied Indemnity. It was held that the person performing an act at the request of another is entitled to compensation from the person who requested the act if the conduct injures a third party and is not tortious to the knowledge of the person executing it. Equitable principles of implied Indemnity were also upheld in *K.P.RM Kuppan Chettiar Vs SP. R.M. RM. Ramaswami Chettiar and Anr*¹⁴ as well as in *Debabrata Ghose vs Jnanendra N. Ghose and Ors*¹⁵.
5. Another issue is that Section 124 and section 125 of the Indian Contract act have not explicitly mentioned when the indemnifier liability begins. It has been a matter of conflict amid various courts. In *Osman Jamal & Sons V. Gopal*¹⁶, it was observed that before formally releasing his liability, the plaintiff was entitled to compensation from the indemnifier. The court held that "The repayment does not necessarily give Indemnity after payment. Indemnity requires that the party to be indemnified shall never be called upon to pay; however, in *Shankar Nimbaji v Laxman Sapdu*.¹⁷

¹¹ "Burnished –Burnished ISSN-2582-5534 ISSN-2582-5534" (*BURNISHED LAW JOURNAL – ISSN-2582-5534* August 11, 2022)

¹² Wayne Courtney, Indemnities and the Indian Contract Act 1872, 27 NAT'L L. Sch. INDIA REV. 66 (2015).

¹³ (1938) 40 BOMLR 868

¹⁴ AIR 1946 Mad 472

¹⁵ AIR 1960 Cal 381

¹⁶ AIR 1929 Cal 208, 118 Ind Cas 882

¹⁷ (1940) 42 BOMLR 175

and *Chand Bibi v Santosh Kumar Pal*¹⁸, it was held that the indemnifier obligation does not start until the indemnified party has experienced damages.¹⁹

‘Section 125- It includes the Rights of the indemnity-holder when sued. The promisee in a contract of Indemnity, acting within the scope of his authority, is entitled to recover from the promisor. The promisee in a contract of Indemnity, acting within the scope of his authority, is entitled to recover from the promisor.

All damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;

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 promisor and acted as it would have been prudent for him to act in the absence of any contract of Indemnity, or if the promisor authorized him to bring or defend the suit;

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 promisor 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 promisor authorized him to compromise the suit.’²⁰

Recommendations to address the shortcomings of section 124 and section 125 of the Indian Contract Act

While comprehending the meaning of Indemnity in *Gajanan Moreshwar v. Moreshwar Madan (1942)*²¹, the Bombay High Court held that the Indian contract act is not exhaustive and common law principles must be applied while interpreting Indemnity.²² Thus, custom-based regulating principles relevant to contract understanding will continue to apply to indemnifying terms unless there is a

¹⁸ AIR 1933 Cal 641

¹⁹ “Law of Contract- When Is the Contract of Indemnity Enforceable” (*Legal Service India - Law, Lawyers and Legal Resources*)

²⁰ Indian Contracts Act, 1872, s 125

²¹ (1942) 44 BOMLR 703

²² LawBhoomi, “Contract of Indemnity: Meaning, Concept and Nature” (*LawBhoomi* August 19, 2021)

The Law Commission makes several recommendations from India's 13 Reports.

1. The Law Commission believes that the definition of "implied indemnity" under Section 124 of the Indian Contract Act has to be updated to encompass additional types of indemnification, such as damages due to accidents, natural disasters, and other events. Before recommending a revision to the Indian Contract Act of 1872, the Law Commission of India noticed and discussed each of the issues mentioned above in its 13th report. The Commission 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. The Law Commission notes an "implied contract" of Indemnity in its report. Although an implied contract may contain an implicit assurance of Indemnity, it is crucial to distinguish between the two ideas.
2. It also suggested that Section 125 be amended to add the necessary language defining the promisor's obligation, which does not automatically arise when the promisee is harmed.
3. According to the Law Commission, the Indian Law of Indemnification, covered in Section 124 of the Indian Contract Act, is insufficient because it does not outline the many components of Indemnity. Similarly, it was said of Section 125 of the Indian Contract Act, where once more, Indian law disregards the promisee's rights. Courts frequently must rely on the Indian legal system, which is roughly equivalent to English law in this regard.
4. The Law Commission also asserts that not all of the promisee's rights are contained in the rights listed in Section 125 of the Indian Contract Act. Some judges and courts have agreed that the promisee can exercise his right to indemnification and be freed from any duties imposed by the promisor regardless of whether he has suffered a loss, but others have disagreed. On the other hand, the Law Commission agrees with the view taken. The Commission referenced the following to clarify the idea further, and the judges that agreed with the stance applied the English Law of Indemnity.
5. According to various proposals made by the Indian Law Commission, the contract of indemnification under sections 124 and 125 of the Indian Contract Act should be expanded to include several new elements to make it broader. Indian law departs from English in Indemnity and

follows its path in numerous ways. On the other hand, their similarities greatly outweigh their differences.

The interpretation of the indemnity provision reveals that there are legal loopholes in Indian law about the true definition of indemnification. However, these flaws are closed when necessary through jurisprudence and court proceedings. Reports like the Law Commission of India 13 Report, as well as critical judgments like *Gajanan Moreshwar v. Moreshwar Madan*²³ are essential for developing new legal concepts and strengthening those that already exist. Indian courts should uphold English Law and its regulations, but not to the point where they are wholly impacted. Every contract lawyer needs indemnities in their toolkit, which are typically a contentious discussion area in contracts. In many cases, the legislation governing indemnities is unclear and convoluted.

Conclusion

While the indemnification provision is well-developed, it has been found to fall short in several situations where the law, as outlined in the Indian Contract Act 1872, leaves significant gaps regarding Indemnity's characteristics.

In addition, Section 124 of the Indian Contract Act 1872, which defines what an indemnity is under Indian law, only emphasizes one kind of compensation and completely disregards the need for the judiciary to coordinate what should be done in circumstances where various indemnities, such as those resulting from events like storms starting a fire or natural disasters, failed to incorporate the implicit form of Indemnity. Because a person cannot claim Indemnity until none of the losses stated in the contract has been incurred, the Indian Law of Indemnity falls short of expectations in defining and allocating entitlements to the promisee. This undermines the fundamental idea of indemnification. This creates a massive issue for the legal system and leaves the said promisee, unable to make up for the losses on their own, in a vulnerable position.

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