
INTERPRETATIVE ANOMALIES IN THE LAW OF INDEMNITY UNDER THE INDIAN CONTRACT ACT, 1872

Ann Alice Philip, Symbiosis Law School, Pune

ABSTRACT

In Indian law, indemnity is governed by only two sections of the Indian Contract Act, 1872.¹ Section 124 describes a contract of indemnity as an agreement under which “one party promises to save the other from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person,” making indemnity a promise to indemnify losses. Section 125 confines remedies to litigation contexts, creating uncertainty in non-litigation scenarios. The neglect of non-pecuniary losses including reputational losses and business disruption arises due to the exclusive focus on monetary compensation. Adding further to this is the absence of provisions for modern indemnity structures and a failure to address emerging new-world risks such as cyber-attacks and data breaches. Comparatively, the UK model however, adopts a more expansive approach to this issue which is quite in contradiction to the minimalist approach that India maintains regarding concepts of guarantee and bailment. While courts have bridged these gaps through progressive interpretation, as through the judgment in Gajanan Moreshwar Parelkar, legislative reforms remain essential to give structure and to align indemnity law with commercial realities and to establish a coherent framework for effective allocation of risks which were never legislatively addressed.

Key Words: - Contract of Indemnity, Indian Contract Act 1872, Interpretative Anomalies, Commercial Risk Allocation, Human Agency Limitation, Modern Commercial Transactions.

¹Indian Contract Act, 1872, Act No. 9 of 1872, §§ 124-125.

INTRODUCTION

One unique aspect of the Indian definition is the focus on "promise," making indemnity a prospective duty instead of a backward-looking remedy. This contrasts with the traditional English common law approach, where indemnity has been considered primarily as a mechanism for reimbursement, triggered only by subsequent loss. Although the Indian definition in theory provides for more anticipatory application, judicial interpretation in practice has restricted this potential.

However, these rights under sections 124 and 125 are narrowly framed within litigation contexts ("when sued"), creating uncertainty about entitlements in non-litigation scenarios- a significant legislative gap.

The Indian model mainly acknowledges express contracts of indemnity, as opposed to the UK model² which includes both express and implied indemnities in connection with various commercial relationships. Furthermore, Indian law seems to confine indemnity to losses brought about by human agency,³ as opposed to more expansive approaches in jurisdictions such as the UK covering losses arising from events outside the control of human beings.

Temporal limitations also prevail in Indian law, with customary interpretations believing that indemnity rights accrue only upon payment being made, thus posing practical problems for cash-starved parties.⁴ This is not the case under the UK system, which in some instances allows recovery prior to actual payment.⁵

The UK's more expansive approach addresses aspects unaddressed in the Indian context, including:

1. Temporal aspects of indemnity claims
2. Implied indemnities in commercial relationships
3. Indemnity against losses from non-human causes

²German Insurance Contract Act 2008 & Insurance Act 2015 UK

³ [2014] 3 SLR 609

⁴Avtar Singh, Law of Contract and Specific Relief 12th ed. (Eastern Book Company, Lucknow, 2021).

⁵Atlantic Richfield Co. v. Petroleum Pers., Inc., 768 S.W.2d 724 (1989)

4. Procedural aspects of enforcing indemnity rights

Section 125's limited interpretation confines protection to litigation situations, overlooking instances where losses arise without court proceedings- a practical deficiency because most commercial losses don't entail litigation but are still within indemnity's protective umbrella.

Lastly, the concept of promise in Section 124, in theory permitting preventive loss, has been eroded by interpretations putting a premium on actual loss for enforcement of rights of indemnity. This conceptual conflict between promissory definition and enforcement in terms of loss is causing dissonance in applying indemnity principles.

INTERPRETATIVE ANOMALIES

The fundamental anomaly results from the narrow application of Section 124's definition, which seems to limit indemnity to human agency-caused losses. The words "conduct of the promisor himself, or by the conduct of any other person" give rise to a human-centred approach to indemnity that shuts out losses caused by natural disasters or other non-human sources. The 13th Law Commission⁶ was aware of this limitation and suggested broadening the definition to cover protection against losses arising from occurrences beyond human control. This suggestion is in recognition that risks tend to originate from varied sources, such as natural disasters, market movements, and other non-human causes.⁷

The need for the expansion becomes self-evident when looking into the function of indemnity contracts in commercial purposes, which has the tendency of offering full indemnity against every possible risk of whatever origin.⁸ The existing man-made limitation inappropriately hampers the protective function of indemnity from being effective as it should have been in commercial uses.

Another significant anomaly lies in the title and scope of Section 125, which is narrowly framed as "Rights of indemnity-holder when sued." This framing creates uncertainty about the indemnity-holder's rights in scenarios not involving litigation. The provision's focus on situations

⁶Law Commission of India, 13th Report (Government of India, 1958).

⁷Kalita, A., Hake, D., Varma, R., Panchbhai, A. and Vasmatkar, A. (n.d.) 'Narrow Yet Broad; Clear Yet Blur: The Law of Contract of Indemnity in India', Russian Law Journal

⁸Pollock, F. and D.F. Mulla, Indian Contract and Specific Relief Acts 15th ed. (LexisNexis, New Delhi, 2019).

where the indemnity-holder has been sued overlooks:

1. Pre-litigation scenarios where costs or losses have been incurred
2. Situations where losses arise without any litigation
3. Preventive measures that may be taken to avoid potential losses

This restrictive stance is contrary to the promise-based definition under Section 124, which implies an anticipatory protection mechanism as opposed to a mere reactive remedy after litigation.

In the case of *Gajanan Moreshwar Parelkar v. Moreshwar Madan Mantri*⁹ the Bombay High Court generalized the rights of the indemnity-holder by holding that the right to indemnity also accrues as soon as the liability is certain, and not merely on actual payment. The court's reasoning was pragmatic, recognizing that insisting on actual payment prior to enforcing indemnity rights would unduly put financial pressure on the indemnity-holder, and quite possibly weaken the very object of the indemnity agreement. This judicial remedy thus solved the temporal anomaly in the classical approach to indemnity rights, but it is still a judicial solution and not a legislative amendment.

The provisions primarily focus on monetary losses, failing to address other dimensions of loss that may be equally significant in commercial contexts. These might include:

1. Reputational damage
2. Business disruption
3. Mental distress and anxiety
4. Lost opportunities
5. Damage to business relationships

This one-dimensional loss concept does not keep pace with the multifaceted nature of

⁹*Gajanan Moreshwar Parelkar v. Moreshwar Madan Mantri*, AIR 1942 Bom 302

commercial harms, especially in modern business settings where intangible assets make up much of business value.

By concentrating only on monetary compensation, the section overlooks the possible value of specific relief in a given situation. In certain situations, specific performance or injunctive relief may better protect the loss than monetary damages, especially when the loss consists of assets or opportunities that are not replaceable.

Modern commercial practices have evolved to include sophisticated indemnity arrangements that address various contingencies and risk allocations not contemplated in the archaic provisions of the Indian Contract Act. These include:

1. Contingent indemnities triggered by specific events
2. Partial indemnities with monetary caps or percentage-based coverage
3. Tiered indemnity structures with different levels of protection
4. Time-limited indemnity periods
5. Indemnities against regulatory or compliance risks

Lack of provisions dealing with these contemporary concepts raises doubts as to their enforceability and interpretation within the Indian legal system.

The need implied in classical interpretations that the indemnity-holder should first endure the loss before he can be indemnified causes undue financial burden.¹⁰ This policy subjects the indemnity-holder to the initial expense of the loss, which can lead to liquidity problems and business interruption, before he can be reimbursed. This is counter to the sheltering purpose of indemnity contracts and can make them useless to parties with insufficient funds.

The anomalies in the provisions of indemnity are a reflection of their historical background and the economic climate at the time they were drafted. The Indian Contract Act was passed in 1872, in the colonial period, with little regard for the intricacies of contemporary commerce. The

¹⁰Komu Kutti v. Kumara Menon, AIR 1919 Mad 367

economic scenario has changed beyond recognition since then, but these provisions have not changed much, and hence there is a gap between legal principle and commercial practice.

SUGGESTIONS AND CONCLUSION

Although courts have commendably filled gaps through innovative interpretation, legislative amendment would bring more certainty and coherence to this vital commercial tool. A reformed regime should widen the definition under Section 124 to include categorically losses arising out of all reasons, natural incidents and market volatility, following the 13th Law Commission's suggestions. Restructuring under Section 125 is needed to cover the rights of indemnity-holders exhaustively- measures for prevention prior to loss, when loss is inevitable, where loss has happened without court proceedings, and the present court proceeding-oriented cases. The law must clearly state that indemnity rights accrue when liability is certain, not merely after payment, enshrining the principle laid down in *Gajanan Moreshwar Parelkar*. Amended provisions must recognize multidimensional losses other than monetary damages, such as reputational loss and disruption of business, while accepting specific relief as an alternative remedy where monetary compensation is insufficient.

The legislative structure needs to adapt to cover modern indemnity arrangements like contingent, capped, and regulatory indemnities, backed by sound procedural rules of claim. The minimalist approach to indemnity is in sharp contrast to the lavish treatment of other contractual notions such as guarantee and bailment—a disparity hard to justify considering the commercial importance of indemnity. Colonial-era drafting in current provisions poses interpretative difficulties that streamlined drafting can solve. Moreover, the interaction between indemnity and insurance is worthy of legislative consideration, demarcating a clear line between these mechanisms of risk allocation. Digital change has created new risk situations—cyber-attacks, data leaks, and intellectual property thefts—that revised provisions should clearly speak to. Finally, indemnity law should effectively distribute risk in commercial transactions, a function the present minimalist provisions do not serve, generating unnecessary expense through interpretative ambiguity and litigation. A contemporary, thorough framework would promote efficiency with continued flexibility, offering the transparency necessary for proper risk management.