

## **“Consideration” in the Contract of Indemnity – An Analysis**

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### **Abstract**

Under the English Common Law and the Indian Law, one cannot conceptualize a contract without consideration. The “relevance” of the concept of consideration dates back to the 14<sup>th</sup> century, when the need to find an answer to differentiate between enforceable promises and unenforceable promises was greatly felt. Though, it is not denied that the intention to create a legal relationship is equally fundamental in elevating a mere promise from the status of an agreement to a status of “contract”. This paper however, focuses on the other side of the coin (consideration), which mandates the presence of consideration, in the Contract of Indemnity. This paper is an attempt to analyse the concept of consideration and the provisions of consideration in the Indian Contract Act, 1872 with reference to the Contract of Indemnity given u/s 124 and 125 of the Act. This paper would also focus on the flaws and deficiencies in the law of indemnity under the Indian Contract Act, 1872 and the various nuances of the concept of consideration in the Contract of indemnity under the Indian Contract Act, 1872. The author post analysis of the relevant sections under the Indian Contract Act, 1872, would attempt to make some humble submissions/ suggestions to bridge the deficiencies in the law, if any.

### **Keywords**

Consideration, English Common Law, Indian Contract Act, 1872; Contract of Indemnity

### **1. Introduction**

The term “indemnity” has various gradations and nuances. In the general parlance, it can be used as an umbrella term wider enough to cover losses, caused by both human and non-human agency. However, the author in this paper restricts the analysis of the term “indemnity” as mentioned u/s 124 and 125 of the Indian Contract Act, 1872. Along with “indemnity” under the said sections, the author, would also look into the relevance of

consideration in the contract of indemnity and the applicability of the sense/ definition, if any, of the expression consideration as given under the Indian Contract Act, 1872 to the Contract of Indemnity, also given under the said Act.

The primary focus of this paper would be to look into the flaws/deficiencies, in the law of indemnity under the Act, along with the “aspect of consideration” in the said law/contract, which has arisen over a period of time, due to advancements/innovations made in knowledge, awareness or technology, and have remained unaddressed till date. The said deficiencies/flaws, if duly addressed and taken care of, would open doors for better understanding of the concept and would allow better implementation of laws in the commercial world.

## **2. Consideration in the Contract of Indemnity under the Indian Contract Act, 1872**

From the time of the enactment of the Indian Contract Act, 1872 till date, the commercial world has taken a gigantic leap in terms of volume, frequency and aspirations of people. The society has always been in the state of persistent transition moving from one development to another. Evolving of new laws, principles and keeping the laws updated with time and pace of society appears more like mandate on the law making bodies, who also owe the obligation, to review laws and update them from time to time and fill gaps which have been caused due to swift advancements and strides in the society, failing which the laws would fall on ground and would be left obsolete and redundant.

With this background, the authors attempts to analyse the concept of consideration, the law of indemnity and the applicability of the “sense” of “consideration” as given u/s 2(d) of the Indian Contract Act, 1872 to the Contract of Indemnity under the Act. The author would then venture to make humble submissions with respect to the deficiencies in the law of indemnity, under the Indian Contract Act, 1872, along with the concept of consideration in the said contract, and make necessary suggestions to bridge the gap under the said law. The flaws, as per the author, in Section – 2(d) of the Act, with respect to the contract of Indemnity are as follow:

- a) The sense of “consideration” as given u/s 2(d) of the Indian Contract Act, 1872, neither “defines” the expression “consideration” nor is it

“substantive” in nature. The very nature of the “sense” of the term “consideration for promise” as provided under the said section is “procedural”.

- b) Another trait of, “consideration” in the contract of indemnity, is its innate “future and fluctuating” aspect in the contract of indemnity, which is not provided for clearly in the Act, neither under the law of indemnity nor under any provision of consideration under the Act. It is of relevance to state here that the expressions “future” is different<sup>1</sup> from the expression “executory” and the executory aspect (words in italics below) of consideration is very well provided u/s – 2(d) of the Indian Contract Act, 1872, which provides the “sense” of the expression “consideration for promise”, which states as follows:

“S.2. Interpretation-clause.—In this Act the following words and expressions are used in the following senses, unless a contrary intention appears from the context:—

(d)When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or, *promises<sup>2</sup> to do or to abstain from doing, something<sup>3</sup>* such act or abstinence or promise is called a consideration for the promise;”

### **3. Deficiency in the Law of Indemnity under the Indian Contract Act, 1872**

On analysis, the author is of the view that, as per “definition” of the expression “consideration” as given by Lush, J., in *Currie v. Misa*<sup>4</sup>, which states, “A valuable consideration, in the sense of the law, may consist either in some *right, interest, profit, or benefit* accruing to the one party, or some forbearance, detriment, *loss, or responsibility*, given, suffered, or undertaken by the other”. One can see, “Right/interest as also one of the attribute of consideration along with loss.” Accordingly, along with “loss” as given u/s 124; right as provided u/s 125 is also one of the aspect of consideration in the contract of indemnity.

Section – 124 of the Indian Contract Act, 1872, defines Contract of Indemnity as follows:

“Contract of Indemnity” defined, “A contract by which one party promises to save the other from *loss<sup>5</sup>* caused to him by the *conduct of the promisor himself, or by the conduct of any other person<sup>6</sup>*, is called a “contract of indemnity”.

- a) On analysis of the said section, the expression “loss” used in the said section, is an attribute of consideration, in the Contract of Indemnity. The said definition of the Contract of Indemnity is restrictive in as much as it covers the loss caused by human agency only, which is in contrast to the English Common Law, under which the Contract of Indemnity is wider enough to cover losses caused by both human and non-human agency. Section – 124 of the Act, also does not expressly provide for the contract of indemnity to be either expressed or implied.
- b) Neither Section 124 nor Section 125 provide for the rights of the indemnified (indemnity-holder), when not sued?
- c) Section – 125 of the Act lays emphasis on rights of the indemnified in the event of his being sued. The said section is also restrictive in as much as it fails to state the rights of the indemnifier and also the rights of the indemnified in the event of not being sued. The said section fails to provide for the point of time when the liability of indemnifier to pay for the loss becomes absolute, either it is the time when the loss has actually taken place or it is the time when the liability of the indemnity holder to pay has become absolute irrespective of the sufferance of actual loss.
- d) Neither Section 124 nor Section 125 provide for the right of subrogation in the contract of indemnity, which is an innate right of the indemnifier under the English law. The Indian Contract Act, 1872 is silent about it.

#### **4. Submissions**

- a) Section – 2(d) of the Indian Contract Act, 1872 be accordingly enlarged/ amended to cover the future and fluctuating aspect of consideration in Special Contracts (viz. the Contract of Indemnity).
- b) Section – 2(d) of the Indian Contract Act, 1872 be improved to cover the substantive aspect of the term and not just the procedural aspect.
- c) Section – 124 of the Act, be accordingly enlarged to cover losses covered by both human and non-human agency and it should also be clearly provided under the said section, that the contract of indemnity could be either expressed or implied<sup>7</sup>. Though the said concern has been taken up by the Law Commission of India in its

Thirteenth Report, 1958, but it still remains pending implementation and execution till date.

- d) An explanation to Section – 124 stating, that the “loss” include “cost” be expressly provided and that “loss” caused by “change of law” is not “loss” as contemplated u/s 124 of the Act, unless section – 124 is enlarged and an explanation stating “change of law”<sup>8</sup> also covered u/s 124 is made.
- e) An explanation stating that the liability of the indemnifier to pay arises at the point of time when the liability of the indemnity holder becomes absolute irrespective of the sufferance of the actual loss, be provided in the Act. The said recommendation has also been made by the Law Commission of India, in its Thirteenth Report, 1958; also supported by the author, is still pending for due implementation and execution.
- f) Further, Rights of Indemnity-holder when not sued, should also be clearly provided for in the Act, a concern which has also been duly addressed by the Law Commission of India, in its Thirteenth Report, 1958 and insertion of a new Section – 125 A after Section – 125 of the Indian Contract Act, 1872 has been accordingly recommended, though the same stands pending implementation and execution. The rights of the indemnity-holder in case of not being sued includes – right of the indemnity-holder to compel the indemnifier to set apart a fund for the discharge of the liability of the indemnified arisen by the decree in favour of a third party. The said right holds goods, irrespective of the fact whether the decree/relief can be effectively enforced against the indemnified. Further, the said right holds goods, irrespective of the sufferance of any actual loss; absolute liability to pay is sufficient to enforce the said right.
- g) Right of Subrogation is innate in the Contract of Indemnity under the English Common Law. The Indian Contract Act, 1872 is silent on the Right of Subrogation.<sup>9</sup> The said right be expressly provided in the law of indemnity under the rights of the indemnifier in the Contract of Indemnity under the Act. However, there is another humble submission by the author that, the right of subrogation to the indemnifier holds good only in cases, where the losses are caused by human agency and/or losses are caused by non-human agency

and are accordingly covered by third party viz. insurance etc. In case, the loss is caused by non-human agency, firstly, it would fail to qualify for the contract of indemnity u/s 124 of the Act. Secondly, even if, the definition of section – 124 is enlarged, even then, the loss cannot be recovered by the indemnifier from the actual wrong doer, when the actual loss is caused by agency like GOD viz. natural events and is not covered by insurance.

## **5. Conclusion**

This paper is a sincere attempt by the author, to highlight the deficiencies in the law of indemnity under the Indian Contract Act, 1872, along with the deficiency in the “sense” of the expression “consideration for promise”, with respect to its applicability on the contract of indemnity, under the Indian Contract Act, 1872. This paper focuses on the various nuances of the concept of consideration and the contract of indemnity, which though fundamental in the formation of the contract of indemnity, have remained unaddressed till date. The author, concludes on the note that considering the above suggestions would not only fill gaps in the law of indemnity under the Indian Contract Act, 1872 but at the same time it would open doors for better understanding of the law on indemnity and its implementation and execution.

## **References**

1. It is fundamental to first understand and not to confuse “future” aspect of consideration with the “executory” consideration. By “future” aspect of consideration in the contract of indemnity we refer to an ingredient of “uncertainty” both objectively (at the time of formation of contract) and subjectively (at the time of actual execution/implementation of contract). By “future” consideration in the contract of indemnity, we mean uncertainty w.r.t happening of loss or not; when the liability to pay for the loss would be incurred etc. Since the answers to such questions are not in contemplation of the parties at the time of formation of contract, the consideration (loss) has a future aspect, at an objective stage (formation of contract) as well as subjective stage (execution of contract). But in case of executory consideration the aspect of uncertainty does not exist at the objective level (formation of contract). Since the parties have with certainty

contemplated the contract at the formation level itself, it is only its actual execution (subjective aspect) which is pending. The difference between future aspect and executory aspect has not been highlighted or dealt anywhere. This difference is crucial for better understanding of the law on indemnity. And the “future” aspect of consideration in the contract of indemnity also has a “fluctuating” aspect in as much as there is a degree of uncertainty w.r.t to the actual liability to be incurred which would be dependent on a future event and not to be exclusively determined by the limit put in the contract of indemnity.

2. The words in italics refer to the “executory” aspect of consideration in section – 2(d) of the Indian Contract Act, 1872.
3. The expression for “consideration” in the “sense” as given u/s 2(d) of the Act, is “*something*”. What constitutes “something” is a matter of constant debate and deliberations. However, definition of “consideration” as given by Lush, J. in *Currie v. Misa* (1874 75) L.R. 10 Ex. 153 case has been of great help, which was decided in the year 1875 (Three years after the enactment of Indian Contract Act 1872), it makes a fine attempt to “define” consideration as, a *right*, profit, interest etc. on one hand and detriment, forbearance, *loss* etc. on the other.
4. (1874 - 75) L.R. 10 Ex. 153
5. It is an aspect of consideration in the contract of indemnity.
6. The definition of “Contract of Indemnity” as given u/s 124 of the Act is restrictive in as much as it covers loss caused by human agency only.
7. In *Lala Shanti Swarup v. Munshi Singh & Ors.* case AIR 1967 SC 1315 (Contract of Indemnity can be implied, principle of subrogation evolved as Remedy to cover up the loss).
8. *M/s Sumitomo Heavy Industries Limited v. Oil & Natural Gas Commission of India* case AIR 2010 SC 3400, “Cost” is “Loss”, however, loss caused due to , “change of law” is not contract of indemnity u/s – 124 of the Indian Contract Act, 1872. The same could be contract of indemnity, in the loose sense of the term.
9. The Landmark Judgment of the Constitutional Bench of the Hon’ble Supreme Court of India in the case *Economic Transport Organisation v. M/s Charan Spinning Mills (P) Ltd. & Anr.* (2010) 4 SCC 114, expressly provides for the right of subrogation in the Contract of Indemnity as innate and inherent; the said

judgment impressively explains the Concept of Subrogation; Together with difference between express subrogation and implied subrogation; Meaning of Assignment; Difference between Subrogation and Assignment; Categorization of Subrogation – Subrogation by equitable agreement; Subrogation by contract; Subrogation cum Assignment.; Principle of Subrogation.