INDEMNITY, A LEGAL COUNTER: GIVE YOUR CONTRACTS A SHELTER!

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This article explores certain basic aspects of indemnity. Considering indemnity is a crucial clause in the agreement, lets clear our basic understanding around this concept[1]

1. What is indemnity?

To indemnify means to make good the loss or damage. Section 124 of the Indian Contract Act, 1872(Contract Act) defines a contract of indemnity as: "A contract by 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".

Sometimes, a party may be entitled to an indemnity where the relation between the parties is such that either in law or in equity there is an obligation upon one party to indemnify the other. Lets understand with an example:

A and B enter into an agreement. A may agree to indemnify B, i.e. A shall have to make good the **losses** that B suffers because of any acts or omissions of B. The key words here are **acts or omissions and this takes us to the second question.**

2. What should one indemnify for?

There is no straightforward answer to this, and there are no relevant obligations defined under the Contract Act as well. Contracting parties are always free to determine what would they would prefer to indemnify for.

Recently, RBI issued a Master Direction on Outsourcing of Information Technology Service on 10th April, 2023[2]. The said circular specifies clearly that the outsourcing agreement should consider the indemnities to be incorporated for the service provider.

Thus, indemnity needs to always be a thought through provision. Typically, an indemnity clause in an agreement would require the provider or the supplier to indemnify the customer for many factors like breach; Nnon-compliance of applicable laws; IPR claims; breach of confidentiality or generically for any other loss that is attributable to Party A.

[1] The article reflects the general work of the author on the date of publication and the views expressed are personal. No reader should act on any statement contained herein without seeking detailed professional advice.
[2] RBI/2023-24/102 DoS.CO.CSITEG/SEC.1/31.01.015/2023-24

One may also choose to either not indemnify, if one so decides and request the purchaser to avail other remedies under the law or absolutely limit it to extremely crucial factors as per the facts and considerations.

Generally, in cases of licenses wherein one-party claims to be the owner of certain proprietary materials and grants a license to use to the other, an indemnity may be expected against any infringement claims unless it's a **as is where is** arrangement[3]. An interesting aspect of IPR indemnity was observed in the recent judgement of Delhi High Court: **Lava International versus TELEFONAKTIEBOLAGET LM ERICSSON,** delivered on 28th March 2024[4].

In this case, Lava was sued by Ericsson for infringement of Standard Essential Patents (SEPs). Ericsson submitted that the suit patents were implemented by Lava in its devices without any proper license agreement. Lava was asked to pay INR 244 crores to Ericsson as the Supreme Court found Lava to be an unwilling licensee of chipsets of Ericsson.

Of the many contentions, Lava contended that it was entitled to use the products implementing the patents of Ericsson from the component suppliers under the Doctrine of Exhaustion, i.e. a principle in patent law, which limits the rights of patent holders after the first authorised sale/import of a patented product, to claim immunity from patent infringement. The Court questioned that , "if Lava believed that such suppliers had a license, **Lava should have obtained an indemnity from such chipset suppliers in this regard ……"**

Admittedly in this case, Lava had neither entered into necessary agreements nor obtained the necessary indemnities, and this case went against Lava. Thus, considering the nature of the transaction, important indemnities should be carved out in the contract amongst the Parties.

[3] An arrangement wherein no warranties of any sort are made and the licensor agrees to obtain the material the way they are. In such cases, licensee may not have any remedies against the licensor if the materials are found to be of poor quality or infringing.
[4] CS(COMM) 65/2016 : Delhi High Court

3. How should you indemnify the other party?

The procedure of indemnifying another party is as crucial as the indemnity clause itself.

Parties may record a clause to state that in case of any claim under the indemnity clause, there should be a notice given to the indemnifying party and such party may choose to contest the claim at its cost. A duty to mitigate on the indemnified party can be recorded from a procedural aspect to ensure that the losses are mitigated to the maximum extent possible.

On the language of the clause, there are three phrases which generally appear in an indemnity clause, and it is crucial to understand the risks under the distinct phrases:

Sample Clause	Liability of indemnifying party- A
A agrees to **hold harmless** B against any claim that B may receive under this Agreement due to A's breach.	When A agrees to hold B harmless, then any claim may be required to be completely looked into by A to ensure that B does not suffer any harm of any nature whatsoever. This may also include assuming all losses and damages suffered due to such claim.
A agrees to **defend** B against any claim that B may receive under this Agreement due to A's breach, at A's costs.	A is required to defend B from any possible claims that B may receive due to A's breaches.
A agrees to **indemnify** B against any claim that B may receive under this Agreement due to A's breach.	This would be a standard indemnity clause.

Each of the phrases convey a different meaning and thus a different obligation altogether.

A judgement from California draws the difference between **hold harmless and indemnifying obligations.** In the case of Queen Villas Homeowners Association v. TCB Property Management[5] it has been observed that,

"The words "indemnify" and "hold harmless" are not synonymous. One is offensive and the other is defensive — even though both contemplate third-party liability situations. "Indemnify" is an offensive right, a sword which allows an indemnitee to seek indemnification. Hold harmless" on the other hand is defensive which simply provides for a right not to be bothered by the other party itself seeking indemnification."

From an indemnified party's perspective, holding harmless language may be preferred while the indemnifying party may want to limit the same.

4. Is indemnity obligation similar to a guarantee obligation?

No, guarantee is legally construed differently and can be enforced in an easier and much swifter manner. Guarantee[6] always involves a third party- guarantor or surety, unlike an indemnity which is generally executed amongst the contracting parties.

In an interesting case of **State Bank Of Saurashtra vs M/S Ashit Shipping Services P. Ltd. & Anr on 12 April, 2002**[7], the Bank sought to enforce an indemnity document under the Summary Suit Procedure, by equating the indemnity bond with a guarantee. The Parties disputed on the nature of the document being a guarantee or merely an Indemnity. The Court observed that on the face of it the document appears to be an Indemnity and not a Guarantee. The Court referred to the Code of Civil Procedure,1908 and outright refused to enforce indemnity bond as a guarantee and specifically ruled that:

"It is to be seen that under sub-rule (2)(iii) of Rule (1) of Order 37 a claim could be made on the basis of a guarantee. Significantly Order 37 CPC does not provide for a claim based on an Indemnity Bond. The reason is obvious. ***In cases of claims on Indemnity Bonds, the loss would first have to be proved.*** *Thus, a summary procedure cannot be adopted in such cases."*

[5] Court of Appeal, Fourth District, Division 3, California. No. G037019 Decided: February 28, 2007
[6] Section 126 - A "contract of guarantee" is understood to be a contract to perform the promise, or discharge the liability, of a third person in case of his default.
[7] AIR 2002 SUPREME COURT 1993

5. How are indemnity clauses enforced?

Indemnity is required to be enforced through the dispute resolution mechanism under the agreement or applicable laws. While indemnities are enforceable and parties may draw relief, the procedure adopted is similar to the enforcement of a contract. Thus, upon obtaining the final decision of enforcement of indemnity, the final decree shall have to be executed as per the standard civil mechanism under the applicable laws of the land. Execution of a decree is again a legal procedure and may depend on various factors.

In some cases, when the indemnity forms a part of a debt arrangement, then such indemnity obligations may be considered as a **financial debt** section 5(8)[8].

However, if there is no debt or disbursal and the indemnity is just for breach of the obligations under the Agreement, then the same shall not be considered as 'financial debt' under Section 5(8) of IBC[9]. Recently, NCLT held that indemnity of the obligations under the Agreement is not a 'financial debt' under Section 5(8) of IBC if there is no disbursement of money or debt.

[8] Section 5 (8) of the Insolvency and Bankruptcy Code provides for guarantee /indemnity obligations
[9] Reserve Bank of India v Reliance Capital Limited CP. (IB) No. 1231/MB/C-I/2021s

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