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I. INTRODUCTION:

The old adage, ***"It is better to be safe than sorry"*** can also be said to be embodied in the process of negotiation of contracts, namely in the form of indemnity and damages provisions. Owing to this, often, a significant amount of time and effort is put into the negotiation of the reliefs available to the respective clients in the event of a breach of contract. These reliefs can broadly be classified into ***monetary, i.e., indemnity or damages, or non-monetary, i.e., inter alia, injunction and specific performance.***

Indemnity and damages are independent, yet closely related aspects of the negotiation of commercial contracts. With the inset of globalization and growth in business transactions, trade and commerce, these provisions have assumed substantial importance, rendering them almost indispensable in contracts. The careful and intelligent construction of these provisions is a crucial aspect of drafting such contracts. Keeping the above in mind, an evident question crops up: ***which one of them affords better protection to the client?*** In this context, it is also important to clarify if the two could be contractually limited. This essay aims to address this question, as well as, throws light on the concept of indemnity and damages in-depth, while also highlighting the stark differences between the two. Further, it aims to suggest various inclusions and drafting measures in order to construct unassailable indemnity and damages provisions.

II. LEGAL POSITION OF INDEMNITY IN INDIA:

In layman's language, indemnity is an undertaking to make good the monetary or other loss which may be caused due to damage.

According to the Black's Law Dictionary[1], indemnity is defined as "*A collateral contract or assurance, by which one person engages to secure another against an anticipated loss or to prevent him from being damnified by the legal consequences of an act or forbearance on the part of one of the parties or of some third person*".

1 Henry Campbell Black, Black's Law Dictionary 910 (Fourth Edition 1968).

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Under Indian law, indemnity is briefly covered under Sections 124 and 125 of the Indian Contract Act, 1872 (the "**Contract Act**"). Section 124 defines indemnity as, "*A contract by which one party promises to save the other from loss caused to him by the contract of the promisor himself, or by the conduct of any other person*..". Whereas, Section 125 sets out the rights of the indemnity-holder when sued.

The Bombay High Court, in ***Shankar Nimbaji Shintre vs. Laxman Supdu Shelke***[2], held that indemnitee could not ask the indemnifier to cover his losses until the loss actually occurred. However, the same court, while mitigating the constraint of common law, expressed a different view in *Gajanan* ***Moreshwar Parelkar vs. Moreshwar Madan Mantri*** (the "**Gajanan Moreshwar Case**")[3], wherein it pronounced that an indemnity might be worth very little if the indemnified could not enforce his indemnity till he had actually paid the loss, indicating that in the event the indemnified has incurred an absolute liability, he is entitled to call upon the indemnifier to save him from that liability and to pay it off, even before occurrence of actual loss.

It is pertinent to note another important position laid down in the ***Gajanan Moreshwar Case***[4], with regards the interpretation of indemnity clauses. The Bombay High Court held that the Contract Act is not exhaustive in this respect, and validated reliance on common law principles for the purpose of interpretation of such clauses, provided they are in consonance with the Contract Act and judicial decisions of the Indian courts.

III. LEGAL POSITION OF DAMAGES IN INDIA:

In common parlance, damages are a remedial monetary award to be paid to a claimant as compensation for loss or injury arising out of a breach of contract. Damages are statutory relief available under the Contract Act, independent of parties specifically agreeing to it or not.

2 Shankar Nimbaji Shintre v Laxman Supdu Shelke, AIR 1940 Bom 161.
3 Gajanan Moreshwar Parelkar v Moreshawar Madan Mantri, AIR 1942 Bom 302.
4 *Id.*

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According to the Black's Law Dictionary[5], damages are "*a pecuniary compensation, which may be recovered in the courts by any person who has suffered loss, detriment or injury, whether to his person, property, or rights, through the unlawful act or omission or negligence of another."*

The Contract Act extensively covers provisions on damages under Sections 73 and 74. Covering damages or loss caused by breach of a contract, it states that "*When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it...*" .[6]

It also emphasizes on compensation for breach of contract where penalty is stipulated for, and states that, "*When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled, whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for…*".[7]

With regards to the abovementioned provisions, it is evident that damages can be claimed only when there is a breach of contract. Additionally, in ***Lakhmi Chand vs. Reliance General Insurance[8]***, with reference to the decision in ***B.V. Nagaraju vs. Oriental Insurance Co. Ltd Divisional Officer, Hassan[9],*** it was conclusively held that the in order to be able to claim

5 Henry Campbell Black, Black's Law Dictionary 466 (Fourth Edition 1968).
6 Section 73, The Indian Contract Act, 1872, No. 9, Acts of Parliament, 1872 (India).
7 Section 74, The Indian Contract Act, 1872, No. 9, Acts of Parliament, 1872 (India).
8 Lakhmi Chand v Reliance General Insurance, AIR 2016 SC 315.
9 B.V. Nagaraju v Oriental Insurance Co. Ltd Divisional Officer, Hassan, AIR 1996 SC 2054.

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damages, breach of contract must be so fundamental in nature, that it brings the contract to an end.

IV. PRIMARY DISTINGUISHING FACTORS BETWEEN INDEMNITY AND DAMAGES:

The fundamental distinguishing features of indemnity and damages are set out below:

IV.I Time of claiming:

Damages can be claimed only on actual occurrence of loss/injury resulting in breach of contract, whereas, under Indian jurisprudence as iterated in the case laws above, the indemnity holder is entitled to enforce the indemnity clause and claim even before occurrence of any actual damage or loss, on basis of incurrence of liability, if agreed by the parties while entering into the contract.

IV.II Third-party claims:

Damages encompass only claims of parties to the contract, whereas indemnity clauses offer protection to the indemnified against third party claims as well. This gives the concept of indemnity a major upper hand, as compared to damages.

IV.III Duty to mitigate losses:

Section 73 of the Contract Act imposes a duty on the claimant to take reasonable steps to mitigate losses, barring claiming of those losses which they failed to mitigate despite reasonable opportunity. The Explanation to this Section[10] states that, "*In estimating the loss or damage arising from a breach of contract, the means which existed of remedying the inconvenience caused by the non-performance of the contract must be taken into account*". The claimant must also be cautious as to not act unreasonably resulting in increase in the loss. Whereas, no such explicit or statutory duty to mitigate losses is cast on the indemnified party. Additionally, in the case of damages a clear nexus is required to be established between the

10 Section 73, The Indian Contract Act, 1872, No. 9, Acts of Parliament, 1872 (India).

breach of contract and damages suffered, whereas, under indemnity, inferring from the fact laid down in the ***Gajanan Moreshwar Case***[11], that claim of liability incurred is maintainable even before occurrence of actual loss, it is safe to say that there is much lesser emphasis on such a pre-requisite.

IV.IV Remote losses, reasonability and foreseeability:

The real test for damages is reasonability and foreseeability of damages. In other words, damages are not sustainable for loss of profit or opportunity cost, and additionally, must be of such nature which the party knew, at the time of making the contract, as likely to result from the breach of it.

The provision in the Contract Act[12] itself expressly excludes claims for remote or indirect damages by stating, "*When a contract has been broken, the party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage caused to him thereby, **which naturally arose in the usual course of things from such breach, or which the parties knew, when they made the contract, to be likely to result from the breach of it***".

However, a claim for indemnity is not restricted by pre-conditions of reasonability, foreseeability or remoteness.

In ***Total Transport Corporation vs. Arcadia Petroleum Limited***[13], it was held that indemnity may refer to all losses attributable to a particular cause, irrespective of reasonable contemplation between the parties. Hence indemnity avails a larger ground for claim under such clause, unless of course such consequential and remote losses are specifically excluded in the contract.

11 Gajanan Moreshwar Parelkar v Moreshawar Madan Mantri, AIR 1942 Bom 302.
12 Section 73, The Indian Contract Act, 1872, No. 9, Acts of Parliament, 1872 (India).
13 Total Transport Corporation v Arcadia Petroleum Limited, [1998] 1 Lloyd's Rep. 351 (United Kingdom).

Further, in case of liquidated damages or other stipulation in nature of a penalty, the claimant is not entitled to receive compensation exceeding the amount so named or stipulated for.

This position was re-iterated in ***Oil and Natural Gas Corporation Ltd. vs. SAW Pipes Ltd.*** [14], where the Supreme Court observed that in all such cases, the court has jurisdiction to award such sum only as it considers reasonable, but not exceeding the amount specified in the contract. Inversely, due to the inapplicability of the reasonability, foreseeability and remoteness principles to an indemnity clause, parties are able to claim larger amounts, and hence prefer, a capped indemnity clause compared to a liquidated damage clause.

Conclusively, based on the above, it is safe to say that indemnified parties are undoubtedly on a better footing for claiming monetary reliefs, as compared to parties merely claiming damages.

V. DRAFTING AN INDEMNITY CLAUSE:

In order to limit the court's discretion whilst interpreting the contract, it is common practice for parties to insert a limited indemnity provision wherein the extent of indemnity is pre-determined. The said safeguard can be provided by way of an 'Exclusive Remedy' clause.

This clause ensures that the indemnity provided shall be the only remedy in relation to the transactions contemplated under the agreement, and further iterates that it shall be to the exclusion of all other available rights and remedies.

Owing to the lack of jurisprudence on the interpretation of exclusive remedy clauses in India, damages as a statutory remedy cannot be ruled out in toto. However, since damages have to satisfy the test of foreseeability, the courts may rule that the quantum of indemnity envisaged under the contract may be used as a basis of determining the extent of damages. Alternatively,

14 Oil and Natural Gas Corporation Ltd. v SAW Pipes Ltd., AIR 2003 SC 2629.

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parties may also resort to limitation of liability, which helps to cap the quantum of liability only to the amount and conditions of indemnity stipulated under the contract.

VI. NEGOTIATION AN INDEMNITY CLAUSE[15]:

VI.I FROM THE INDEMNIFIED PARTY'S PERSPECTIVE:

VI.I.I Omission of certain words:

Terms like 'make good' and 'compensate' should be avoided as the court may interpret it as claims arising only out of actual loss suffered by the indemnified party and may not extend it to cases where the liability has accrued but remains unpaid. Therefore, the term 'hold harmless' should be used to include conditions of accrued liability.

Further, the terms 'result of' or 'connection of' should be avoided because a close nexus needs to be established if the aforesaid terms are used. Rather terms like 'arising out of' should be used as they have a broader connotation.

VI.I.II Usage of certain terms:

The term 'protect from liability' shall be included so that an additional burden is cast upon the indemnifying party to defend the indemnified party against third party claims. Since indemnification is an equitable right, the clause may provide that the obligation to defend the indemnified party shall come into play the moment any claim is made by a third party.

VI.I.III Defining losses and liability:

As opposed to an exhaustive definition, an inclusive definition should be used which means that the phrase 'losses mean' should be avoided and the phrase 'losses include' shall be used. An inclusive definition assists in claiming indirect and remote losses.

[15] SATISH PADHI, RUCHIR SINHA & VYAPAK DESAI, *Revisiting The Indemnity V/S Damages Debate*, available at http://www.nishithdesai.com/information/news-storage/news-details/article/revisiting-the-indemnity-vs-damages-debate.html.

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VI.II FROM THE INDEMNIFYING PARTY'S PERSPECTIVE[16]:

VI.II.I Specific exclusions in limitation of liability clause:

Since this clause is an exculpatory clause, it is given a very strict interpretation. Thus, any exclusions that an indemnifying party wants to incorporate, should be expressly mentioned in the said clause. The indemnifying party may want to exclude claims of which the indemnified party had actual or constructive knowledge, and contingent liability unless it becomes due and payable and where provisions for certain liabilities have already been made in the books of accounts.

VI.II.II Duty to mitigate:

The duty to mitigate arises only if it is specifically mentioned in the indemnity clause. Therefore, to cast an obligation on the indemnified party, the indemnifying party may want to explicitly provide for the indemnified party's duty to mitigate in the indemnification clause.

VI.II.III Limitation of remedy clause:

It is pertinent to reiterate that contracts may have a limited liability clause which caps the liability of the indemnifier, but this does not rule out the possibility of other contractual remedies being pursued against the indemnifier. Thus, insertion of a limitation of remedy clause is recommended, which brings limited liability as well as exclusive liability under its garb.

VII. CONCLUSION:

Indemnity and damages are closely related topics as both are remedies that may be claimed by an aggrieved party, yet, they differ significantly in usage and principle. Although damages are a statutory right, indemnity undoubtedly offers a wider protection as compared to damages. As discussed, indemnity can be claimed even before the claimant has suffered any actual loss,

[16] *Ibid.*

against third party claims, for indirect and remote losses and even without showing direct nexus between the breach and the claim under question.

Conclusively, indemnity clauses should be given greater importance, and closely negotiated upon, while drafting commercial contracts. The carve-outs and inclusions for a water-tight indemnity clause should be focused upon, failing which, adverse situations may crop up for contracting parties.