

# ENFORCEMENT OF INDEMNITY PROVISIONS IN COMMERCIAL CONTRACTS





Indemnity clause is an important provision in commercial contracts. The objective of this clause is to transfer or allocate risk between the parties to the contract by protecting a party against any risk/liability arising on account of an act or omission or breach or default by the other party. This article deals with the aspect relating to enforceability of indemnity clause in commercial contracts.

## **COMMENCEMENT AND EXTENT OF LIABILITY UNDER INDEMNITY OBLIGATIONS**

### **COMMENCEMENT OF LIABILITY**

The purpose of the indemnity obligations contained in the commercial contracts is to protect the indemnified party from any loss or liability which the indemnified party has incurred or will incur. The indemnity clause is a contractual transfer of risk between two contractual parties and is one of the most negotiated clauses.

One of the most important aspects is when does the liability of the indemnifier commence or can be called upon by the indemnifying party to enforce the indemnity obligations. In this regard, the Indian courts have held that indemnity can be claimed by the indemnifying party even before the actual incur of loss.<sup>1</sup> The Indian courts have also made it clear that an indemnified party can sue the indemnifier even before suffering any loss, provided the indemnified party is able to satisfy the court about the existence of a clear enforceable claim against him or her and that the contract of indemnity covers the claim.

Further, the English courts have also stated that indemnity does not merely mean to reimburse in respects of moneys paid, but to save from the loss in respect from the liability against which the indemnity has been given.

Moreover, in the case of *Welspun Infratech vs Ashok Khurana*<sup>2</sup>, the Hon'ble Bombay High court has held that the indemnifying party has to indemnify the other party irrespective of the challenges or defenses relating to such breach of contract or the non-compliances by the indemnifying party.

### **EXTENT OF LIABILITY**

In relation to the extent of the liability of the indemnifier, the Hon'ble Bombay High court in the case of *Gajan Moreshwar Parelkar vs Moreshwar Madan Mantri* has held that if the indemnified party has incurred a liability and that liability is absolute, he is entitled to call upon the indemnifier to save him from that liability and pay it off.<sup>3</sup>

The Indian courts in determining the liability of the indemnifying party have noted that the indemnity holder can sue for specific performance of the contract of indemnity provided it is shown that absolute liability has been incurred by him.

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<sup>1</sup> 2011 (113) BOMLR1725

<sup>2</sup> 2014(2)ARBLR520(Bom)

<sup>3</sup> AIR 1942 Bom 42



## INDEMNITY IN CROSS-BORDER COMMERCIAL AGREEMENTS

The aspect of indemnity has become even more debatable in cross border commercial contracts. There is a lack of judicial clarity on the issue of remittance of money in the form of damages from an Indian resident to a person resident outside India.

The Foreign Exchange Management Act, 1999 (“**FEMA**”) deals with the remittance of money from an Indian resident to a person resident outside India and vice-versa. In terms of FEMA, each transaction has to be classified as a capital account transaction or a current account transaction to remit the money from an Indian resident to a person resident outside India.

In terms of section 2(e) of FEMA, capital account transactions mean any transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India. Such capital account transactions require the prior approval of the Reserve Bank of India (“**RBI**”) unless specifically permitted. Further, in terms of section 2(j) of FEMA, any other transaction other than a capital account transaction is a current account transaction. These transactions do not require any special permission from RBI, unless specifically mentioned.

There is a lack of consensus and clarity from RBI as to whether the remittance of money as indemnity is to be considered as capital account transaction or current account transaction.

Further, it is pertinent to note that in terms of section 3(b) of FEMA, any payment to or for the credit of any person resident outside India in any manner has to require the general or special permission of RBI. This clause encapsulates the broad ambit of remitting money by a resident to a person resident outside India for any purpose requires the prior approval of RBI.

However, recent judgements by the Hon’ble Delhi High court in the matter of *NTT Docomo Inc. vs Tata Sons Ltd.* and *Cruz City 1 Mauritius Holdings vs Unitech Limited* are a welcome step to address these issues.

### **NTT Docomo Inc. vs Tata Sons Ltd.**

In the case of *NTT Docomo Inc.* (“*Docomo*”) vs *Tata Sons Limited* (“*Tata*”)<sup>4</sup>, a petition was presented in relation to the remittance of damages to a non-resident from a resident in India before the Hon’ble Delhi High court.

The dispute between Tata and Docomo was in relation to the breach of the shareholders agreement where Tata failed to reach certain performance based milestones, due to which Tata had to find a suitable buyer of the shares of the Docomo. Upon the arbitration between both the parties in London, the arbitral tribunal decided that Tata should compensate Docomo. Docomo filed a petition for the enforcement of the arbitral award in the Delhi High court. Thereinafter RBI intervened and stated that the money should not be remitted outside India without their prior approval.

The court on that issue of prior approval of RBI to remit damages from Indian resident to a non-resident stated that as the award is in the form of damages and not purchase price of shares, there is no need for any special permission of RBI for remission by Tata of the amount awarded thereunder to Docomo.

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<sup>4</sup> O.M.P.(EFA)(COMM.) 7/2016



## **Cruz City 1 Mauritius Holdings vs Unitech Limited**

In another recent judgement in the case of Cruz City 1 Mauritius Holdings vs Unitech Limited<sup>1</sup>, the Hon'ble Delhi High court also dealt with repatriation of damages from India to overseas. The court opined that FEMA would not be applicable to cases where a foreign investor finds its claim in breach of contract. Plainly, if an investment is made on representations which are breached by the Indian counterpart, the foreign investor would be entitled to its remedies including damages. The court specifically stated that the foreign exchange laws would not be applicable in cases where a foreign investor exercises the option as a remedy for breach.

This is evident from the judgements of the Hon'ble Delhi High court that repatriation of damages shall not require the prior approval of RBI. However, as a practice the authorized dealer banks still insist prior approval of RBI for repatriation of damages overseas.

### **Our Offices**

#### **New Delhi**

14<sup>th</sup> Floor  
Dr. Gopal Das Bhawan  
28, Barakhamba Road  
New Delhi 110 001  
T: +91 11 4213 0000  
F: +91 11 4213 0099

#### **Mumbai**

1<sup>st</sup> Floor, Bajaj Bhawan  
226, Nariman Point  
Mumbai 400 021  
T: +91 22 49100000  
F: +91 22 49100099

#### **London**

The St Botolph Building  
138 Houndsditch  
London EC3A 7AR  
T: +44 20 7876 4848  
F: +44 20 7875 5132

E: [info@clasislaw.com](mailto:info@clasislaw.com)

W: [www.clasislaw.com](http://www.clasislaw.com)

### **CONCLUSION**

The Indian laws relating to the enforcement of indemnity in commercial contracts and repatriation of money overseas from India has been evolving rapidly. Moreover, these recent judgements by the Indian courts will instill confidence and encourage foreign investors to make more investments in India.

Basis these limited and recent judgements, it shows that the courts have taken a step to preserve the parties' intention in the commercial agreements. However, the aspect of enforcement of indemnity and remittance of money in the form of damages from India to overseas needs to be discussed by the Hon'ble Supreme court of India and a codified regulation by RBI is sought to avoid any further ambiguities.

-by Abhisek Choudhury, Associate

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