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THE REVIVAL OF 'ACTUAL DAMINIFICATION' RULE: DECONSTRUCTING THE JUDICIAL APPROACH IN INDIA AND ENGLAND ON DETERMINING COMMENCEMENT OF LIABILITY IN CONTRACTS OF INDEMNITY

- Arunabha Banerjee

I. Introduction

Indemnity is a contract of recompense wherein the indemnity holder can claim the contracted amount from the indemnifier if the holder has suffered a loss either due to the conduct of the indemnifier or any third person.[1] The payment of the contracted amount may either depend on the actual losses incurred and proved by the holder (based on the maxim 'you must be damnified before you can claim to be indemnified'), or become payable upon the liability of the holder becoming absolute by the happening of an event. While the conventional interpretation of indemnity in common law only allowed indemnity claims supported by proof of actual loss, the rigours of common law were gradually mitigated through a series of judicial pronouncements that focused on the equitable rather than the strict legal view of the indemnity. The equitable construct placed a greater emphasis on whether the liability of the holder could be conclusively determined. The underlying rationale for this construct was that the object of an indemnity contract is not just to offer a recompense but also save the holder from loss.

As both approaches continue to operate parallelly, evidenced by the cases dealt with in the following sections of this article, it becomes important for a student or practitioner of law to understand the point at which the liability of the indemnifier commences. While the literal interpretation of Section 124 read with Section 125 (rights of the indemnity holder) of the Indian Contract Act, 1872, emphasises on the requirement of actual loss (damages, costs or settlement sum as mentioned in Section 125)[2] to sustain a successful claim by the holder, judicial interpretation suggests that the claim may arise simply based on existence of liability without proof of any actual loss to the holder.

This article will explore these authorities and identify a rule that can be used as a definitive principle to determine the commencement of liability of the indemnifier against the holder. Part I of the article will introduce the topic and explain the approach adopted in formulating an effective rule to determine the point at which the liability of the indemnifier against the holder

[1] Indian Contract Act 1872, s. 124; See also *Halsbury's Laws of India* (2nd edn, 2015) vol 9, para 95.173.
[2] Wayne Courtney, 'Indemnities and the Indian Contract Act 1872' (2015) 27(1) National Law School of India Review <https://repository.nls.ac.in/nlsir/vol27/iss1/10> accessed 4 March 2025.

commences. Part II will examine the evolution of English law through an extensive review of the important judicial pronouncements and how they contributed to a shift from the traditional common law approach of the actual damnification in determining liability under indemnity contracts. Part III will shed light on the judicial interpretation of Sections 124 and 125 of the Indian Contract Act, 1872, and the impact of the Chancery Court rulings on the construction of both these statutory provisions. Part IV will focus on some notable case developments after the landmark rulings in India and England that qualify our understanding of the commencement of the indemnifier's liability under these landmark cases. Finally, Part V will formulate a rule that will allow the reader to apply it to all indemnity cases and determine the point at which the liability of the indemnifier starts.

II. Position of English Law on Commencement of the Indemnifier's Liability

The issue of determining the point at which liability of the indemnifier to pay to the holder was first conclusively decided in the seminal case of *In Re Law Guarantee Trust and Accident Society, Limited v. Liverpool Mortgage Insurance Company's Case*[3] (***'Liverpool Mortgage'***). In this case, Law Guarantee Trust and Accident Society ('**LGTAS**') guaranteed the payment of the principal and interest on debentures issued by Sands, Wilson & Co. ('**S&W**'). Two-eleventh of the amount payable by LGTAS was reinsured by Liverpool Mortgage Insurance Company ('**LMIC**'). The cause of action arose when S&W defaulted in paying their debenture holders in 1907. On December 13, 1909, an extraordinary resolution was passed for the voluntary winding up of LGTAS, and on July 28, 1910, a scheme of arrangement was sanctioned by Neville J under Section 120 of the Companies (Consolidation) Act, 1908, directing to pay the final dividend. The liquidators of LGTAS claimed the payment of the amount stipulated in the reinsurance contract by LMIC. However, LMIC argued that no actual payment had been made by LGTAS to the debenture holders. LMIC stressed on the distinction between contracts of insurance and indemnity, the former requiring the happening of an event of default and an ensuing loss for a successful claim by the insured. Since no actual payment had been made by LGTAS to its liquidators or debenture holders, LMIC was not liable to pay the stipulated reinsurance amount. The liquidators' claim against LMIC was also barred by the rule of privity, as the contract of reinsurance was solely between the insurer and the reinsurer. Neville J, speaking for the Chancery Division, noted that the reinsurance contract between LGTAS and LMIC was not in the nature of indemnity. Neville J distinguished this insurance contract from

[3] [1913] 2 Ch 604.

fire and marine insurance, which required the insured not to profit from the loss or destruction of its property. Through this distinction, it was observed that the reinsurance contract in the present case was in the nature of a guarantee where only a portion of the covered risk had to be paid by LMIC in the event of default by LGTAS towards the debenture holders of S&W. Neville J acknowledged the difficulty met by the person facing the primary liability of debt to pay if no funds are made available by the person with secondary liability. His Lordship observed that the ruling of *In re Richardson, Ex parte the Governors of St. Thomas's Hospital,*[4] allowed LGTAS to claim the entire indemnity amount from LMIC as soon as the liability arose in favour of the debenture holders, but such amount could not be used to meet other financial obligations of LGTAS. Allowing the insurer to claim in excess of the actually paid amount from the reinsurer could allow the insurer to profit, which was not the underlying objective of a contract of insurance. Neville J suggested that this problem of excess benefit may be resolved through the application of equity in ensuring that any excess amount paid to the insurer by the reinsurer should be adjusted in the balance premium left to be paid by the insured. Accordingly, the Chancery Division ruled that LGTAS could not claim the reinsurance simply upon mortgaging its assets unless it had actually parted with those assets in favour of its liquidators.[5]

The decision was, however, overturned by the Court of Appeal.[6] Buckley LJ noted that the possibility of LGTAS turning insolvent and being unable to pay its claims would not have been factored into determining the premium it paid to LMIC. Such a determination was predicated upon the happening of the event of default only and not anything else. Also, it was observed that the approach in determining LMIC's liability on actual payment of dividends by LGTAS was incorrect as S&W's liability had already arisen at the point when LGTAS went into liquidation. If LGTAS had not gone into liquidation, its right to enforce the dividends against S&W would have been intact. Buckley LJ concluded that LGTAS could not possibly have a lesser right simply because the assets proved insufficient to ensure dividend payments to the debenture holders. LGTAS' right to claim the reinsurance from LMIC arose as soon LGTAS went into liquidation and the sum owed to the debenture holders became ascertained. Buckley LJ, therefore, ordered for the payment of the reinsurance amount after deducting the value of mortgaged assets from the total amount due to the debenture holders, i.e., two-elevenths of

[4] [1911] 2 KB 705.
It would not help a man to make a profit out of what was merely an indemnity. If, for instance, B was bound to pay a sum to A and C was bound to indemnify B, which is the case before us, then B could not sue C unless he could aver payment to A.
[5] [1913] 2 Ch 604, 609.
[6] [1914] 2 Ch 617.

4988l. 6s. 11d. Kennedy LJ, in a concurring but separate opinion, drew support from Wright J's observations in *Wolmershausen v. Gullick*[7] and noted that "…*to indemnify does not merely mean to reimburse in respect of moneys paid, but…to save from loss in respect of the liability against which the indemnity has been given*." His Lordship clarified that contrary to the Chancery Division's observation, per Lord Stirling, in *In re Eddystone Marine Insurance Co*.[8], payment by the insurer was not a condition precedent for a successful claim against the reinsurer. The liability of LMIC arose as soon as LGTAS became obligated to pay the debenture holders. It made little sense in law for LMIC to argue that they would wait to see how much LGTAS actually paid in the discharge of their liability to the debenture-holders. Lastly, Kennedy LJ distinguished the facts of the current case from *In re Richardson, Ex parte the Governors of St. Thomas's Hospital*[9] where the circumstances were peculiar. The wife in that case was sued by the trustee in bankruptcy of her husband's estate jointly with the husband's landlord. The right involved was not a contractual right but an equitable obligation arising from the relation of *cestui que* trust and trustee. The Court of Appeal had held that the trustee could avail himself of the indemnity only for the purpose of passing on the money, which his wife paid by way of compromise to the landlord, the co-plaintiff, and the principal creditor. To hold otherwise would be to allow a trustee to profit out of his position. However, in the present case, the claim by LGTAS depends upon an express contract for the payment, in case of happening of a certain event, of a sum of money. The debenture-holders were not privy to the reinsurance contract and LMIC had no interest in seeing how the money due from LMIC was applied by LGTAS. Kennedy LJ found the current case more closely aligned with the decision in *Dane v. Mortgage Insurance Corporation*[10] where the insurance company was obligated to pay in the event the bank did not pay. In the present case, LGTAS was not bound to pay the sum payable by S&W to its debenture holders, but only the differential sum left after realization of mortgaged assets. Hence, LMIC's obligation arose as soon as the liability for the payment of the differential sum arose against LGTAS. Kennedy LJ also pointed to the lack of privity between LMIC, S&W and the debenture holders, making it impermissible for S&W to claim directly from LMIC. Thus, the only possible way to execute this transaction was to allow a claim by LGTAS against LMIC as soon as LGTAS became liable to pay to S&W. The

[7] [1893] 2 Ch 514
[8] (1894) W.N. 30.
[9] [1911] 2 K.B. 705,
It would not help a man to make a profit out of what was merely an indemnity. If, for instance, B was bound to pay a sum to A and C was bound to indemnify B, which is the case before us, then B could not sue C unless he could aver payment to A.
[10] [1894] 1 QB 54 (61) (CA).

application of *In re Eddystone Marine Insurance Co*.[11] (‘***Eddystone***’) was clarified by Kennedy LJ. In this case, Western Insurance Co. had obtained reinsurance from Eddystone to ‘pay as may be paid thereon’ in respect of liability arising out of marine insurance. Western Insurance had undergone liquidation and could not pay any dividends to their insured. Stirling J, interpreting the clauses ‘pay as may be paid thereon’ and ‘payment to be made,’ held that Western Insurance could claim payment from Eddystone even in the absence of any actual payments to their assured. It was observed that ‘the payment to be made’ could mean both liability or actual payment. In this case, Kennedy LJ also drew support from *Herckenrath v. American Mutual Insurance Co*.[12] in the American jurisprudence and observed that even when the reinsurer pays the insurer without actual loss incurred, the insurer in liquidation makes no profit as it will be required by the state to distribute its assets to the creditors in a manner stipulated by law. The payment upon liability without actual losses is a part of the risk assumed by the reinsurer when the contract of reinsurance is executed and the premium is paid. Since, in the current case, LGTAS had incurred liability to the debenture-holders for 4988l. and LMIC had insured them against two-elevenths of that risk, latter were obligated to pay for that fraction of former’s liability. Kennedy LJ concluded that even if the insurer pays a small amount of dividend to its assured, the reinsurer must pay the full reinsured amount. Such a payment will be determined by the ‘insurable interest’ in the subject matter where the obligation to pay arises as soon as the insurer becomes ‘liable’ to pay. For instance, in marine insurance, the reinsurer’s liability does not arise upon the actual loss caused to the insurer by drowning of the ship, but by the liability of the insurer upon the event of drowning.[13]

The Court of Appeal’s decision in *Liverpool Mortgage* therefore represented a tectonic shift in the way courts interpreted contracts of indemnity and determined the claim of the holder who sought indemnity without suffering any actual loss. From an actual damnification approach which required the holder to show that he had actually paid for a successful claim against the indemnifier, the focus shifted to determining whether the liability of the holder had arisen.

The following section would discuss the relevant statutory provisions and the judicial interpretation in India that guide our assessment of the indemnifier’s liability when a claim is made against the holder by a third party.

[11] [I892] 2 Ch 423.
[12] 3 Barb Ch 63 (NY 1848).
[13] [1914] 2 Ch 617, 638, 648, 649, 650, 651.

III. Commencement of Liability in Indemnity Contracts under the Indian Law

Section 124 of the Indian Contract Act, 1872, defines a 'contract of indemnity' as a contract where:

a. the indemnifier promises to save the indemnity holder from loss and
b. such loss is being caused to the holder either by the conduct of the indemnifier or a third person.

A bare perusal of the provision suggests that the obligation to indemnify depends on the occurrence of loss. However, it contains no guidance as to whether such a loss should be actually incurred or simple accrual of liability will suffice without any actual loss suffered by the holder. While the phrase 'save the other from loss' points to the possibility of a claim being made based simply to help the holder avoid an actual loss, the interpretation becomes muddled when considered in light of Section 125. This section states the rights of the indemnity holder and allows them to claim damages paid in a suit, costs paid in bringing or defending a suit, and all sums paid under the terms of a compromise. A reading of Section 124 in light of Section 125 would therefore lead us to interpret 'loss' as an amount actually incurred in the form of damages, costs, or settlement sum.

A similar argument was made in *Gajanan Moreshwar Parelkar v Moreshwar Madan Mantri*[14] (***'Gajanan Moreshwar'***) where the question was whether the plaintiff could enforce an indemnity against the defendant based on defaults made in mortgage payments made by the defendant. The cause of action was in relation to a land which was initially leased initially by the Bombay Municipal Corporation to the plaintiff. The plaintiff transferred the benefits of the lease to the defendant, who subsequently commenced construction of a building by procuring materials from a vendor. The defendant asked the plaintiff to create a mortgage in favour of the vendor when he defaulted in payments. Subsequently, the plaintiff transferred the ownership of the land to the defendant but the default in payment under the mortgage continued. The defendant also failed to pay the ground rent to the municipal corporation and get the property insured. Upon being presented with claims by the vendor and the municipal corporation for the failed payments by the defendant, the plaintiff sought to invoke the indemnity against the defendant, asking him to pay the relevant sum in the court for discharging the plaintiff's obligations towards the municipal corporation and the vendor.

[14] AIR 1942 Bom 302.

The defendant argued that the plaintiff had no right of action in the absence of any actual loss suffered. The promise to save the indemnity holder from loss under Section 124 is only with respect to loss actually suffered rather than the loss that may be caused to the holder in the future. The defendant asserted that this interpretation is further strengthened by Section 125 which requires the indemnity holder to actually pay the damages, costs, or sums pursuant to out of court settlements.

However, the above contention by the defendant was rejected by the Bombay High Court. Speaking through MC Chagla J, the court observed that Sections 124 and 125 do not represent the exhaustive code on indemnity law in India. Thus, any gaps in the language of the provisions must be addressed by reference to the relevant principles from common law decisions and equity. The court noted that while the provisions deal with indemnity arising out of loss caused to the holder due to the conduct of the indemnifier or any third person, they do not cater to situations where the holder becomes liable due to acts done by the holder at the request of the indemnifier. The limitation of Section 125 could also be gauged from the marginal note to Section 125, which restricted its application only to cases where the indemnity holder has been sued. Chagla J drew a distinction between the facts of the current case and *Shankar Nimbaji v Laxman Supdu*[15] (‘***Shankar Nimbaji***’) where a mortgage was treated as an indemnity under peculiar circumstances. In *Shankar Nimbaji*, the plaintiff had been issued a promissory note by the second defendant in respect of Rs. 5000 drawn from the account of the plaintiff’s father. The second defendant had used this amount to advance a loan to the first defendant, who secured this transaction by executing a mortgage in favour of the second defendant. Aggrieved by this transaction, the plaintiff sued the first defendant to claim Rs. 5000 plus interest from the proceeds of the sale of the mortgaged property. In case this amount could not be realized from the proceeds, a decree was sought against the estate of the deceased second defendant. However, the Bombay High Court rejected the second claim on the ground that it could not be maintained against the second defendant’s estate merely on the anticipation of the mortgaged property proving insufficient to meet the debt under the promissory note issued by the second defendant. The promissory note was meant to serve as an alternative remedy for the plaintiff in case of loss caused due to the ‘unauthorised meddling with their money’ by the second defendant. The court observed that the plaintiff was free to repudiate the mortgage and sue the second defendant on the promissory note, leaving him to file a separate suit against the first defendant to recover the mortgage amount. However, the plaintiff had opted to enforce the

[15] (1939) 42 Bom LR 175, [3].

mortgage. Thus, the mortgage had to be treated like a contract of indemnity, and the plaintiff could not sue the second defendant for the balance amount from his estate unless the mortgaged property was actually sold and loss was ascertained. Chagla J observed in *Gajanan Moreshwar* that the facts in the case did not warrant a similar interpretation as *Shankar Nimbaji* simply covered one of the many possible interpretations while assessing when the liability of the indemnifier commenced.

The Calcutta High Court's decision in *Chand Bibi v Santoshkumar Pal*[16] ('*Chand Bibi'*) was dismissed by Chagla J on the ground that it was possibly attributable to a specific clause in the contract that required the defendant's father to indemnify the plaintiff only in case of actual payments made by the plaintiff to the mortgagee. The plaintiff, in that case, had agreed to sell a mortgaged property to the defendant's father, on the condition that the buyer pays off the mortgage. The buyer also agreed to indemnify the plaintiff, if made liable for the mortgage debt. Justice Lort-Williams, speaking for the Calcutta High Court, observed that the liability could not have arisen without the commencement of proceedings by the mortgagee against the plaintiff and the plaintiff suffering actual damage. The suit was thus considered premature. Analysing this decision in *Gajanan Moreshwar*, Chagla J observed that the judgement did not consider existing authorities on the relevant point of law. *Chand Bibi* also failed to take into account a similar case before the Calcutta High Court in *Osmal Jamal & Sons, Ltd. v Gopal Purshattam*[17] (**'*Osmal Jamal*'**) where Justice Lort-Williams himself had affirmed the observations made by the Chancery Division in *Liverpool Mortgage* regarding the commencement of liability for an indemnifier without the holder suffering any actual loss. The following observations of Kennedy LJ from *Liverpool Mortgage* were quoted with approval in *Osmal Jamal*:[18]

> "*There appears to me to be authority for holding that, in the view of a Court of Equity, to indemnify does not merely mean to reimburse in respect of moneys paid, but (in accordance with its derivation) to save from loss in respect of the liability against which the indemnity has been given*."

In *Osmal Jamal*, the Calcutta High Court ordered the defendant to pay the indemnity to the plaintiff even though no actual payment had been made by the plaintiff to the vendor for the

[16] (1933) ILR. 60 Cal 761.
[17] (1928) ILR 56 Cal 262.
[18] See also *Wolmershausen v. Gullick* [1893] 2 Ch 514, 527, 528 (Lord Wright).

goods purchased. The order came with a direction that the indemnity amount should be fully transferred by the plaintiff to the vendor upon receipt.

Upon a perusal of all the above authorities, Chagla J observed that an indemnity conditioned on actual loss suffered by the holder would not serve the purpose as the holder may not always be in a position to satisfy the judgement before making the claim to the indemnifier. That was the reason why the courts of equity in England interpreted the commencement of liability of an indemnifier in a manner that mitigated the rigours of common law and allowed the holder to claim regardless of any actual loss. Chagla J thus chose to follow the interpretation given by the Chancery Division in *Liverpool Mortgage*. His Lordship accordingly concluded that as soon the liability became absolute, the holder could ask an indemnifier to pay off the claim. Alternatively, the holder may also pray for the indemnifier to pay into court a sufficient amount which could be utilized subsequently to settle the holder's debt.[19]

The statement of principle on commencement of liability of an indemnifier by Chagla J in *Gajanan Moreshwar* has been affirmed and applied in many subsequent decisions discussed in Part IV. It is also considered as a definitive test for determining an indemnifier's liability by noted commentators such as Pollock and Mulla.[20] However, the author suggests a more nuanced interpretation of Section 124 and 125 based on some key judicial pronouncements, discussed in the following section, that qualify our existing understanding of an indemnifier's liability post *Gajanan Moreshwar*.

IV. Post *Gajanan Moreshwar* and *Liverpool Mortgage* Developments: Key Judicial Pronouncements in India and England Analysed

A. Post *Gajanan Moreshwar* Developments in India

The ruling in *Gajanan Moreshwar* received widespread acceptance in subsequent decisions. Affirming the *Gajanan Moreshwar* ruling, the Gujarat High Court held in *The New India Assurance Company Ltd. v. The State Trading Corporation of India Ltd. and Ors*[21] that if the defendant's obligation under a contract of indemnity is an absolute one, proceedings can be initiated against the indemnifier immediately upon the failure of performance, regardless of any actual loss. Once liability is incurred and it becomes absolute, the holder may call upon the

[19] *Gajanan Moreshwar Parelkar v. Moreshwar Madan Mantri*, AIR 1942 Bom 302, [7]. See also R Yashod Vardhan, Chitra Narayan and Vinod Kumar (trs), *Pollock & Mulla, The Indian Contract & Specific Relief Acts* (LexisNexis 2024) 1300.
[20] *Gajanan Moreshwar Parelkar* (n 19) [7]. See also R Yashod Vardhan (n 19) 1304.
[21] AIR 2007 Guj 517 [9.9B], [9.9C].

indemnifier to 'save him from that liability and pay it off'. Drawing upon the Thirteenth Law Commission's Report, 1958, the court observed that the concept of indemnity in wider than the type covered under Section 124 and 125 that solely address indemnities payable upon proof of actual loss. Generally, indemnity can also be invoked in cases where the liability has conclusively arisen even though no losses have actually been incurred, because the objective of insurance is to save the insured from loss. The compensation paid by the insurer should try to put the insured in a position it would have been in, had the event causing the loss not occurred. The court also noted that due to this reason the Law Commission had recommended adding a new Section 125A to cover rights of holders to enforce indemnity simply on the basis of the holder's liability having arisen against the third party.

In *Jet Airways (India) Limited v. Sahara Airlines Limited*[22] (**'*Jet Airways*'**) a demand of Rs. 107.08 crores was made against Jet by the Income Tax authorities. Jet invoked the indemnity provided under Clause 15.1.1A of the Share Purchase Agreement against Sahara Airlines. Relying on *Gajanan Moreshwar*, Jet contended that once the indemnity holder has incurred liability and that liability is absolute, he may ask the indemnifier to save him from that liability by making the payment. Unless interpreted this way, an indemnity may turn out to be futile.

Upholding Jet's contention, the Bombay High Court in *Jet Airways* also drew support from the following observations of Gajendragadkar J in *Khetarpal v. Madhukar Pictures*[23]:

> "*…an indemnity holder is entitled to sue the indemnifier even before he has incurred any damage, provided of course the indemnity holder is able to satisfy the court about the existence of a clear enforceable claim against him and is able to show that it is in respect of such a clear enforceable claim that a contract of indemnity has been executed*."

The decision of the Calcutta High Court in *Osman Jamal,*[24] citing with approval the observations of Buckley LJ in *Re Richardson Ex parte The Governors of St. Thomas's Hospital,*[25] was also affirmed in *Jet Airways*. Buckley LJ had noted in *Richardson* that "*Indemnity is not necessarily given by repayment after payment. Indemnity requires that the party to be indemnified shall never be called to pay*." Accordingly, the Bombay High Court

[22] 2011 Supp BCR 709 [40]-[41].
[23] AIR 1956 Bom 106.
[24] ILR 56 Cal 262, See also HK Saharay (ed.), *Dutt on Contract* (Eastern Law House 2013) 759.
[25] [1911] 2 KB 705.

observed in *Jet Airways* that the indemnity covered tax demands and the indemnity under the warranty provision in Clause 15.1.1 was triggered when a liability was incurred, without waiting for the actual payment to be made by Jet to the tax authorities.[26] *Jet Airways* has been affirmed subsequently in *Reliance Industries Limited v. Balasore Alloys Limited*[27] where the Bombay High Court observed that even before damages are suffered, the holder may sue for specific performance, provided that the liability has become absolute and that the contract covers such liability.

A subsequent affirmation of the *Gajanan Moreshwar* ruling can be seen in *Welspun Infratech Limited v. Ashok Khurana and Ors*.[28] where the Bombay High Court held that the petitioners were entitled to be indemnified by the promoters for violating the conditions of share closing under the share purchase agreements executed between them. The petitioner's claim was upheld by the court as liability of promoters arose as soon as the various authorities had issued notices demanding payment from the petitioner. The court noted that the petitioner could claim the indemnity amount even if the promoters had certain defences or right to appeal in respect of these issued notices.

A different perspective is however offered by a parallel chain of authorities in India and England, which will be discussed below. These cases require proof of actual damnification of the indemnity holder before allowing the holder's claim against the indemnifier.

In *Abdul Hussain Shaikh Gulamali Jambawalla v. Bombay Metal Syndicate*[29] (***'Abdul Hussain'***), the plaintiff had sold certain goods to the defendant in respect of which the defendant executed an indemnity promising to pay any amount of sales tax 'as and when charged' by the authorities. The Sales Tax Department, by an order dated February 28, 1963, directed the plaintiff to deposit Rs. 3,101.25 as sales tax and Rs. 378 as penalty. The plaintiff asked the defendants to pay the amount, but the latter defaulted. On a date after 27th April, 1963, the plaintiff paid the amount due. To recover that amount the plaintiff filed a suit on 13th April, 1966. Kapadia J of the City Civil Court, Bombay, noted that the matter was governed by Article 113 in the Schedule to the Limitation Act, 1963 which provides "*Any suit for which no period of limitation three years. When the right to sue accrues is provided elsewhere in this Schedule*." Relying on *Gajanan Moreshwar*, Kapadia J held that the right to sue that the

[26] 2011 Supp BCR 709 [41].
[27] 2014 (2) Bom CR15 [19].
[28] 2014 (3) Bom CR 624 [28].
[29] AIR 1972 Bom 252.

plaintiff had acquired the right to sue the defendant as soon as the order was issued by the Sales Tax Department. Thus, three years commencing from 28th February, 1963, had lapsed on 28th February, 1966. Thus, the suit filed after 27th April, 1966, was barred by limitation. On appeal, the Bombay High Court observed that a contract of indemnity may lead to:

a. an ordinary common law cause of action which arises only upon sufferance of actual losses by the plaintiff, or
b. an additional cause of action empowering the holder to ask the indemnifier to pay the amount required to settle claims by the holder's creditors and/or pay into court sufficient sum in anticipation of proceedings that those creditors may initiate against the holder.

The Bombay High Court noted that the additional cause of action could be attributed to rulings of the Chancery Courts in England which observed that actual damnification need not be established by the person seeking indemnity. However, the rulings by these courts of equity have not eliminated the first cause of action in indemnity contracts under which the holder will need to prove actual losses to justify his claim against the indemnifier. Accordingly, the court concluded that in the present case, the limitation period had to be calculated from the actual date of payment of tax after 27th April, 1963. Hence, the limitation period of three years under Article 113, Schedule to the Limitation Act, 1963, could not have expired on 13th April, 1966.

The position is also supported by judicial pronouncements on implied indemnity contracts. *Lala Shanti Swarup v. Munshi Singh*[30] is a case in point. Here, the plaintiffs executed a mortgage on their property in favour of their creditors on 9th May, 1914. On 9th February, 1920, the plaintiffs sold this property to the defendants for Rs. 16,000. It was agreed in this sale transaction that the defendants would be paying Rs. 13,500 directly to the mortgagees towards the amount due under the mortgage. However, the defendants did not pay the mortgage amount leading to a suit filed by the mortgagees against the plaintiffs. The final mortgage decree in this regard was issued on 4th February, 1937, directing the plaintiffs to pay Rs. 26,000. On 22nd May, 1939, the Special Judge ordered for the apportionment of payments between the plaintiffs and defendants with respect to the amount due under the mortgage, each being made liable for approximately Rs. 14,307. After this, proceedings were initiated before the Collector, pursuant to which, on 25th February, 1943, the plaintiffs transferred three-fourths of half of their property to meet their apportioned liability under the mortgage. The plaintiffs estimated that due to the

[30] AIR 1967 SC 1315.

defendants' default in paying the stipulated part of the consideration in the earlier contract of sale, they had to pay an additional Rs. 18,500, which represented a 'loss' on their account. Accordingly, they sued the defendants on 30th July, 1943, claiming indemnity for the loss suffered due to the defendant's default. However, the defendant contended that the suit was time barred, as the limitation period of six years under Article 83 read with Article 116 of the Limitation Act, 1963, had to be calculated from the year 1920 when the defendant breached the contract of sale by failing to pay Rs. 13,500 to the plaintiff's mortgagees. Alternatively, it could be calculated from 4th February, 1937, when the mortgage decree was passed against the plaintiff, with the liability becoming absolute per the rule laid down in *Gajanan Moreshwar*. The objections of the defendants were refuted by the Trial Court and their subsequent appeal to Division Bench of the Allahabad High Court was also dismissed upon a reference made to the Full Bench. The defendants thereafter appealed to the Supreme Court, which made three pertinent observations:

a. The limitation period of six years will be computed from the date of breach of the contract of sale between the plaintiff and the defendant only when the plaintiff sues the defendant directly to specifically enforce the defendant's obligation to pay to the plaintiff's mortgagee;
b. The limitation period prescribed under Article 83 read with Article 116 (registered sale deed) or Article 115 (unregistered sale deed) will apply equally for express and implied indemnity contracts, the current case qualifying as an implied indemnity. To this effect, the Supreme Court relied on the decision of the Judicial Committee in *Musammat Izzal-un-Nissa Begum v. Kunwar Pertab Singh*[31] that if the purchaser of a property enters into a contract with the seller to pay the seller's encumbrances, it amounts to a contract of indemnity; and
c. Lastly, the limitation period of six years will be calculated from 25th February, 1943, the date when the plaintiff actually transferred a share of their property to their creditors pursuant to their liability under the mortgage. Hence, the plaintiff's suit against the defendant was not barred by limitation.[32]

[31] 36 I. A. 203
The purchaser takes the property subject to the burthen attached to it. If the incumbrances turn out to be invalid, the vendor has nothing to complain of. He has got what he bargained for. His indemnity is complete. He cannot pick up the burthen of which the land is relieved and seize it as his own property.
[32] *Lala Shanti Swarup v. Munshi Singh*, AIR 1967 SC 1315 [4], [6].

The following passage from the apex court' ruling, also cited with approval by the Bombay High Court in *Abdul Hussain*, succinctly summarizes the applicable rule for computing limitation period while adjudicating indemnity claims by vendors of mortgaged property against purchasers:

> "*The cause of action in such a case arises when the plaintiff-vendors are actually damnified. The mere fact that a mortgage decree has been obtained against the plaintiff is not sufficient to put the statute in motion… the statute runs not when the event happens which caused the loss but on the actual damnification."*[33]

A few cases in the domain of insurance in India and England, as discussed below, also suggest the addition of new rules and approaches for determining the point at which the liability of the insurer to pay commences. This includes a return to the actual damnification approach based on the construction of the relevant clause in the insurance contract and a clarification that actual liability could not arise simply based on allegations in a dispute.

In *United India Insurance Company Ltd. v. Kantika Colour Lab. and Ors*.[34] a consignment of a printer was damaged due to negligent handling while being transported from Mumbai to Haridwar. Pursuant to a damage certificate issued by the seventh respondent (carrier), the first respondent submitted a claim for Rs. 55 lakhs against the appellants. A preliminary survey was conducted by the appellant company. The first surveyor, submitted a report stating that while the printing machines had been damaged, the film processors, viewed from outside, appeared to be in a sound condition. The appellant then appointed a second surveyor to assess the loss. Pursuant to an inspection by a technical expert, the second surveyor submitted his report stating that the damage caused to the printing machines was capable of being repaired, and assessed the loss to be worth Rs. 5,76,730. However, there was no damage to the film processor. Accordingly, the appellant offered an amount of Rs. 5,76,730 to the first respondent which was declined. Instead, the first respondent filed a complaint before the National Consumer Disputes Redressal Commission, New Delhi, claiming an amount of Rs. 53 lakhs with interest @ 10% p.a., equivalent to the cost of the machines damaged. The Commission found in favour of the respondent and ordered the appellant, jointly and severally with the seventh respondent, to pay

[33] *Abdul Hussain Shaikh Gulamali Jambawalla v. Bombay Metal Syndicate*, AIR 1972 Bom 252 [7].
[34] (2010) 6 SCC 449.

the claimed amount. Respondent, the owner of the machines, obtained from the appellant Insurance Company a transit insurance policy for a sum of Rs. 53 lakhs. The policy covered loss against all risks, including damage/breakage, theft pilferage, road risk, and non-delivery etc. On appeal, the Supreme Court observed that insurance contracts are usually contracts of indemnity. Except life insurance, personal accident, and sickness or contracts of contingency insurance, all other forms allow the insured only to claim actual losses subject to proof. The occurrence of the covered event does not guarantee payment of the amount assured under the policy. Only proved actual losses may be reimbursed subject to any caps imposed under the policy. The court relied on the following passage from the *Halsbury's Laws of England*, 4th Edition, to substantiate its rationale:

> "*The happening of the event does not of itself entitle the assured to payment of the sum stipulated in the policy; the event must, in fact, result in a pecuniary loss to the assured…He cannot recover more than the sum insured for that sum is all that he has stipulated for by his premiums and it fixes the maximum liability of the insurers…The contract being one of indemnity only, he can recover the actual amount of his loss and no more...*"

Accordingly, the apex court concluded that in the current case, only the printing machines had been damaged and not the film processors, regarding which there was simply an apprehension that it may face technical issues in the future. The film processor had been tested by the supplier's engineer, and the tanks of the machines were found filled with chemicals. Around 40-50 empty film rolls were seen lying in the place of the accident. All the reports certified that the printing machines were in working condition. The court therefore held that there was no real basis for apprehending future defects in the film processors and no assumptions could be made in this regard. The first respondent could therefore claim only the actual losses determined by the surveyors.[35] This apex court ruling also represented a divergence from *Gajanan Moreshwar* as it declined insurance coverage upon the happening of an accident where the insured could not prove actual loss to the consignment being transported. The evidence on record failed to disclose any actual loss or a real basis for any future apprehended loss owing to the accident.

[35] ibid [18], [19].

B. Post *Liverpool Mortgage* Developments in England

In England, an affirmation of the *Liverpool Mortgage* ruling can be found in *Cox v. Bankside,*[36] where Phillips J noted that an indemnity that exposes the holder to the possibility of being declared insolvent for inability to claim on the insurance 'would provide an unsatisfactory cover.' Likewise, in *Charter Reinsurance Company Ltd v. Patrick Feltrim Fagan,*[37] reinsurance contracts were executed between two Syndicates and Charter Reinsurance Company Ltd (reinsured). The coverage could be invoked for all 'ultimate net loss' defined as 'sums actually paid by the reinsured in settlement of losses or liability.' Mance J, speaking for the Commercial Court, observed that actual disbursement of money by the reinsured was not necessary to invoke the coverage as the disbursement was not a condition precedent for attracting the reinsurer's liability. The 'ultimate net loss' clause was more of a measure of the liability rather than actual losses. The reasoning was also affirmed by the House of Lords[38] on appeal, which held that the relevant clause had to viewed on the landscape of the instrument as a whole rather than its first impression. Hence, the appellant became liable to pay the reinsurance amount as soon as the respondent had become liable without waiting for the respondent to actually disburse the sum to its insured.[39]

However, where the insured claims defense costs incurred in relation to law suits filed against it and reaching out of court settlements, English courts have imposed additional requirements with respect to the liability for which the coverage amount is being claimed against the insurer. In *Astrazeneca Insurance Company Limited v. XL Insurance (Bermuda) Ltd. and Ace Bermuda Insurance Ltd*.[40] ('***Astrazeneca***') the plaintiff, captive insurer for the Astra Zeneca group, had purchased reinsurance from the defendants to the tune of 50% of the coverage given by the plaintiff to the group. AstraZeneca Pharmaceuticals LP ('**AZPLP**') had manufactured, marketed, and sold in the United States and Canada a drug named 'Seroquel'. On August 28, 2003, a class action was filed against AZPLP where the claimants alleged that Seroquel (i) had caused personal injury; (ii) was defective; and (iii) had failed to provide adequate warning on its packaging. The Complaint was first notified on 11th September, 2003. Since then, numerous

[36] [1995] 2 Lloyd's Rep 437, 453.
[37] [1996] 1 Lloyd's Rep. 261, See also Stephen Lewis, '"Pay as paid" and the ultimate new loss clause' 1995, International Insurance Law Review 1, 2.
[38] [1997] AC 313.
[39] See also David Cabrelli, 'Interpretation of Contracts, Objectivity and the Elision of Consent Reached Through Concession and Compromise' (2011) Juridical Review, 121, 129-130; Neil Andrews, 'Interpretation of Contracts and "Commercial Common Sense": Do Not Overplay this Useful Criterion' (2017) The Cambridge Law Journal 76(1) 36, 48.
[40] [2013] EWHC 349 (Comm).

plaintiffs in the United States and Canada sued the Astrazeneca group alleging that Seroquel has caused them personal injury. Till October, 2012, the plaintiff settled claims presented by AZPLP for legal costs incurred in defending suits and out of court settlements amounting to £83.5 million excess of £365 million. Only one of the suits filed against AZPLP had undergone a full trial leading to a verdict. The remaining claims were dismissed summarily. The insurance was paid by the plaintiff for roughly 50% of settlement sums paid, the remaining amount being declined on grounds like claims relating to injuries caused by the medicine being sold after the date of the Notice of Integrated Occurrence. The plaintiff accordingly sought indemnity from its reinsurer defendants for the settlement sums paid and defense costs incurred within the permissible layer of £133 million above £365 million. However, the defendants, relying on *Enterprise Oil Ltd v. Strand Insurance Co Ltd*[41] (‘***Enterprise Oil’***) refused on the ground that no ‘actual legal liability’ had arisen. The plaintiff filed a suit alleging that even an ‘arguable legal liability’ or ‘alleged legal liability,’ justifying the defense costs incurred and the settlement sums paid, would suffice in supporting a claim for indemnity. The following clause stating the point of commencement of the liability for the reinsurer was in dispute:

> *“For all sums which the Insured [i.e. Enterprise] may be obligated to pay by reason of liability imposed on the Insured by law or assumed under Contract or Agreement (written or oral) or otherwise, on account of personal injury and/or bodily injury and/or loss of life and/or loss of and/or damage to tangible property…”*

However, the England and Wales High Court (Commercial Court) chose to rely on *Enterprise Oil* where Aikens J had observed that even where the insured had settled the claim of the third party, liability towards that third party must still be proved. Simply showing that the amount of the settlement was reasonable would not be sufficient to enforce the indemnity. The applicable test would be whether the amount paid under the settlement was at least the amount the insured would have paid in a judicial proceeding. In *Enterprise Oil*, Aikens J had cited with approval Clarke LJ's ruling in *MDIS v Swinbank*,[42] summarising the principles below:

[41] [2007] Lloyd's Rep IR 186.
[42] [1999] Lloyd's Rep IR 516, 524.

a. Insured must prove the loss caused by the perils insured against;[43]

b. A judgment or an arbitration award must have been issued against the insured or an agreement executed for payment;

c. Loss caused should be within the policy scope;

d. Judgment, award, or agreement may be used for showing a basis of liability being within the scope of the insurance coverage, however this shall not be determinative in all cases;

e. The liability of the insured may be disputed by the insurer on the ground that the true basis of his liability fell within an exception stipulated in the policy; and

f. Insurer may show the claim to be fraudulent or otherwise excluded by the policy, unless the insured shows that it was negligence and not fraudulence which induced his claim.

Accordingly, three broad rules were formulated by the England and Wales High Court (Commercial Court) in for justifying a claim of indemnity:

a. The insured must show actual legal liability, not just an alleged liability;
b. Determination of loss by a judgment or settlement does not automatically prove actual legal liability; and
c. Defence costs would be payable by the indemnifier only if the holder establishes an 'actual legal liability' to pay damages upon a true construction of the contract.[44] Such costs cannot be treated as a liability imposed by law even when there are clauses to that effect. The question of 'actual legal liability' must be determined by applying the correct system of law and through proper analysis of evidence on record.

Applying the above principles, in *Astrazeneca*, the England and Wales High Court (Commercial Court) held that the insurer's liability to pay only arose with respect to sums paid 'by reason of liability...imposed by law' under Article I of the policy. The words 'by reason of' establish the requirement for a 'clear causal link' between the payment and the sanction behind it. Lastly, the court also held that the definitions of 'Ultimate Net Loss', that is 'the total sum

[43] See also *Post Office v. Norwich Union* [1967] 2 QB 363; *Bradley v. Eagle Star Insurance Co Ltd* [1989] AC 957; *Horbury Building Systems Ltd v. Hampden Insurance NV* [2004] 2 CLC 453, 464.

[44] See also *Yorkshire Water v Sun Alliance* [1997] 2 Lloyd's Rep 21, 30-32.

which the Insured shall become obligated to pay for Damages on account of Personal Injury' and 'Damages' that is '…which the Insured shall be obligated to pay by reason of judgment or settlement for liability on account of Personal Injury', did not expand the scope of actual legal liability to alleged liability of the insured for seeking indemnity.

A notable exception to the *Liverpool Mortgage* rule can be found under Section 9(5) read with Section 9(6) of the Third Parties (Rights against Insurers) Act, 2010, which require the marine insurer to discharge its liability prior to seeking indemnity from the reinsurer unless the liability covered is in respect of death or personal injury.[45] This view is also supported by the UK and the Scottish Law Commission which reviewed these 'pay first' clauses and observed that they are vital to the functioning of the mutual insurance business and should only be nullified in cases of insurance provided to cover death or personal injury. Likewise, the House of Lords Special Bill Committee, chaired by Lord Lloyd of Berwick, also supported the use of 'pay first' clauses in mutual insurance contracts used by indemnity clubs where the premium paid is usually insufficient to recoup the assured coverage. [46]

The House of Lords observed in the conjoined appeals in *Firma C-Trade SA v Newcastle Protection and Indemnity Association and Socony Mobil Oil Inc v. West of England Shipowners Mutual Insurance Association (London) Ltd (No 2)*[47] that under the Shipowners' Mutual Protection and Indemnity Clubs Rules, the club member shall receive indemnity upon becoming liable to pay and having in fact paid. The House of Lords held that the clauses in the contracts made payment by the members to the third parties a condition precedent to the clubs' obligation to pay.

In *MS Amlin Marine NV v. King Trader Limited and Ors*.,[48] Amlin Marine NV issued a marine insurance policy to Bintan Mining Corporation (**'BMC'**) covering potential losses suffered by BMC in relation to the vessel chartered from King Trader Limited (**'King Trader'**). When the chartered vessel was grounded in Solomon Islands, BMC claimed damages payable to King Trader. However, relying on the above-mentioned authorities, the England & Wales High Court held that the indemnity could not be invoked by BMC unless it actually paid those damages to King Trader. The court justified its departure from the liability rule laid down in *Liverpool*

[45] Third Parties (Rights against Insurers) Act 2010, ss. 9(5) and 9(6).
[46] *MS Amlin Marine NV v. King Trader Limited* [2024] EWHC 1813 (Comm) [22], [27], [28]. See also Law Commission and Scottish Law Commission, Third Parties - Rights Against Insurers (Law Com No 272 and Scot Law Com No 184, 2001) [5.37].
[47] [1991] 2 AC 1.
[48] [2024] EWHC 1813 (Comm) [64].

Mortgage by highlighting the peculiarities of the mutual insurance business with respect to marine contracts.

V. Conclusion

An examination of the cases discussed under Parts II, III, and IV show contrasting approaches followed by the courts both in England and India in determining the point of time when the liability of an indemnifier arises against the indemnity holder. Since the text of Section 124 or 125 of the Indian Contract Act, 1872, offers no guidance on this point, the reader is compelled to turn to judicial pronouncements for definitive guidance. While the *Liverpool Mortgage* and *Gajanan Moreshwar* rulings stated that the determination of indemnifier's liability depends on the liability of the indemnifier turning absolute – a test that has been widely accepted as the conventional rule by noted commentators such as Pollock and Mulla, the approach fails to take into account situations where the actual damnification rule is better equipped to 'save the holder from loss.'[49] Thus, the parallel chain of authorities, which suggest that either the cases of actual liability rule should be distinguished from cases of alleged liability (e.g. while upholding the holder's claims regarding defense costs and settlement sums), or the payment by the indemnifier should be conditioned on proof of actual loss (e.g. where the court needs to decide whether the holder's claim is barred by limitation, or peculiar cases under marine insurance), need to be considered in conjunction with the tests developed under the *Liverpool Mortgage* and *Gajanan Moreshwar* rulings. The author therefore believes that the proper adjudication of any claims raised under indemnity contracts can be done only by following this blended approach.

After perusing the authorities discussed in the preceding sections, the author proposes the following two-fold test to determine the point at which the liability of an indemnifier commences:

1. **Actual Damnification -** When the contract
    a. expressly requires the loss to the holder to be proved (e.g. marine insurance contracts where a portion of the risk is reinsured by the insurer), or
    b. would be defeated in its object if the loss is allowed to be indemnified simply based on occurrence of liability (e.g. indemnity payable to trustees who must not profit from any transaction connected in relation to the trust.), or

[49] See R Yashod Vardhan, Chitra Narayan and Vinod Kumar (trs), *Pollock & Mulla, The Indian Contract & Specific Relief Acts* (LexisNexis 2024) 1300, 1304.

c. is in the nature of the guarantee where the primary payment by the holder (correctly termed 'principal debtor' in a contract of guarantee) has to be proved to invoke the secondary obligation of the indemnifier (correctly termed 'surety' in a contract of guarantee), or
d. involves a cause of action which becomes barred by limitation when the limitation period is calculated from the date when the liability of the indemnifier first arose,

proof of actual loss must be furnished by the holder to support any claims made against the indemnifier.

2. **Crystallization of holder's liability** – Actual loss need not be proved by the holder when
   a. the liability becomes ascertained, i.e., there arises an enforceable claim in favour of the holder pursuant to a valid contract of indemnity. If such a contract is not honoured by the indemnifier, it would prejudice the holder, defeating the very object of indemnity that is to save the holder from loss.
   b. the liability is actual rather than based on allegations which may not translate to conclusive liability in the future (e.g. defense costs arising in litigations due to allegations in class action suits, where no decree has been pronounced by the court, will not constitute actual liability. Likewise, settlement sums agreed between the litigating parties below any amount which would have been sanctioned by the court in the event of a full-fledged adjudication would not constitute actual liability.). However, for avoidance of doubt, the instances under this item stand on a different footing to those cases where there is a conclusive determination of final liability of the indemnifier. In these cases, the holder's claim against the indemnifier will succeed.