maples teesdale

Time to pay up? Guarantees and Indemnities

Part Two - Indemnities

August 2020

Published by
Rosalind Cullis

Following on from our first article on guarantees, we turn to indemnities.

What is an indemnity?

An indemnity is a contractual promise to accept liability for another's loss. It is a *primary obligation* because it requires payment even if the underlying agreement is void or somehow can be challenged. Unless expressly provided for in the drafting, it can be called upon by the beneficiary without the need to prove any fault, which avoids arguments over causation and mitigation. This means indemnities tend to be more advantageous to creditors than guarantees. However, if there is a dispute, they will still be construed strictly against the party seeking to rely on them.

What are the formal requirements of an indemnity?

An indemnity must satisfy the legal requirements for a valid contract to be enforceable (that is, offer and acceptance, consideration, and an intention to enter into legal relations). Unlike a guarantee, it does not have to be in writing and can be given orally. Having said that, it is clearly better to have the terms properly recorded to avoid disputes further down the line.

Drafting

An indemnity can be provided for almost any loss save that, for public policy reasons, it is not possible to be indemnified for a fine that stems from an illegal or unauthorised act.

Given its contractual nature, the drafting of an indemnity is crucial as this will dictate:

- the event that triggers the indemnity;
- the degree of connection between the event and the loss - wording such as losses "arising out of", "*in connection with*", "*suffered by*" or "*as a result of*" will be interpreted differently. An indemnity might also refer to losses that are incurred directly "*or indirectly*" which may actually limit the recoverable losses; and.
- the heads of recoverable losses - a widely drafted indemnity might allow for recovery of other losses such as legal costs and other professional fees or costs. It may even specify a quantified sum to be paid.

The party giving the indemnity will want to include wording that limits the losses recoverable and requires the claimant to mitigate its loss. The indemnified party, on the other hand, will want the net to be cast widely, with loss recoverable "*whether foreseeable or not*".

Landlord and Tenant

Leases often include indemnity clauses and, unlike guarantees, an indemnity will not be released because of any subsequent lease variation. Such provisions might require the tenant to indemnify the landlord if the tenant is in breach of any covenant. Tenants will want to resist this as, arguably, the landlord has the remedy of seeking damages for a breach of covenant and an indemnity could be considerably more onerous. An indemnity may be more limited in scope, only applying in specified circumstances. Indemnities in lease are controversial and, for example, do not feature in the RICS Code for Leasing Business Premises.

An indemnity may be construed from the wording, even if the word "*indemnify*" is not expressly referred to. This was the case in *Littlestone v Macleish (2016)* where the Court of Appeal relied on the word "*all*", to hold that a tenant's covenant to pay "*all costs and expenses which might be incurred*" entitled the landlord in a dilapidations claim to have his costs assessed on an indemnity basis. This means there is no requirement for the costs to be proportionate and the onus is on the paying party to show that the costs claimed are unreasonable.

Most modern leases are drafted to include both a guarantee and an indemnity to avoid any arguments as to the extent of liability. Particularly in times of an economic downturn, landlords who understand the differences between the two will be better placed to enforce successfully.

For further information please contact:

Rosalind Cullis
E: rcullis@maplesteesdale.co.uk
T: 020 3465 4311