

The breach of contractual indemnities under English law – a debt claim or a damages claim?

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Introduction

Indemnities are a fundamental part of contracts in English law¹, and are often heavily contested and negotiated. ‘No-one likes to give them and everyone wants the benefit of them’². Parties to a contract will look to ensure that any indemnities inserted into the contract reflect their commercial interests, and as a consequence the form of the indemnities inserted into contracts are often some of the most challenged parts of that contract. Unfortunately, this is one of those areas of English law that has not developed to give clarity and certainty to commercial parties.

In their analysis of contractual indemnities, Carter and Courtney identified the split in approach with regards to how breaches of those indemnities are perceived. They state in the first instance that ‘an action to enforce the clause is an action for contract damages’³ but later recognise that ‘in contract, it is sometimes suggested that an action on an indemnity is a claim in “debt”’⁴. Two judgments reported in 2015 from the High Court of England and Wales illustrated this divergence of opinion on how English law deals with breaches of indemnities. The decision in the case of *ABM Amro Commercial Finance plc v Ambrose McGinn & others*⁵ (the “**ABM Amro Case**”) took the approach that a breach of an indemnity gave rise to debt claims. Pursuing an apparently opposite approach, the decision in the case of *Durley House Limited v Firmdale Hotels plc*⁶ (the “**Durley House Case**”), held that breaches of indemnities gave the indemnitee a right to claim for damages. These were two decisions delivered within a few months of each other, seemingly following different approaches.

This apparent lack of clarity in the approaches of the English courts when looking at indemnities is concerning. The purpose of this article is to consider in detail the approaches of the courts to the consideration of the commercial remedies available to parties for breach of indemnities under English law. Does it result in either a debt claim or a damages based claim? Crucially this article will look to determine if English law has reconciled these two approaches, and if it is possible to try to present these decisions of the English courts as being part of a clear overall approach to the interpretation of indemnities.

Firstly a detailed background of indemnities will be presented in order to aid readers to better understand the context of the debt-damages debate. The second part of this article will look at the approach of the English courts in considering breaches of indemnities as giving rise to debt claims as the appropriate commercial remedy. The development of English law to support this approach will be assessed through an analysis of some of the leading judgments that support this position, and a review of how the courts have applied this approach.

The third part of this article will focus on the judgements of the English courts over the years that support the damages claim approach. The merits and limitations of this will be considered, and a comparison made to the debt claim approach.

Finally the article will argue that it is not possible nor advisable to choose a fixed approach under English law for breaches of indemnities. The focus in the courts should be on the interpretation of the indemnity clause in question to determine which remedy is most suitable. The law has attempted to show flexibility

¹ Reference to English law in this essay means the laws of England and Wales, and reference to the English courts means the courts of England and Wales.

² CMS Law Now *Indemnities: what is all the fuss about?* (23 June 2016)

³ J W Carter and W Courtney ‘Indemnities against breach of contract as agreed damages clauses’ [2012] *Journal of Business Law* 555 p558

⁴ *ibid*

⁵ [2014] EWHC 1674 (Comm.)

⁶ [2014] EWHC 2608 (Ch.)

in a complex area, and judges should steer away from firm pronouncements that breaches of indemnities necessarily fall into a specific category.

Background to indemnities under English law

As stated in the introduction above, indemnities are an important feature of commercial contracts, and are often the subject of important negotiation by the parties to the contract. Indemnities have been described as 'a significant part of any contractual dealing'⁷, and it is useful to emphasise the important but contentious nature of indemnities to contracting parties. Despite their importance, there is a relative lack of academic consideration of the topic.

What is an indemnity?

A broad response to that question is set out in a book called the Law of Guarantees, which states that 'an indemnity, in its widest sense, comprises an obligation imposed by operation of law or by contract on one person to make good a loss suffered by another'⁸. A useful practical example to illustrate this can be drawn from the construction services industry, where a Hospital Trust awards a facilities management contract to a contractor after a tender process. The Trust will want to ensure that the contract executed with the contractor includes indemnities in its favour so that the contractor will be liable to pay the Trust a certain sum if, during the life of the contract, certain events occur that result in the employer being exposed to or incurring certain losses. Bennett provides his perspective on contractual indemnities, stating that 'as a general proposition, indemnities look to make the party best able to manage a particular risk responsible for the consequences of the possible event occurring'⁹. Parties therefore negotiate what issues and risks should be covered by an indemnity, and the extent of the cover provided. From a practical perspective, indemnities can be said to be beneficial as they ensure that the party that can manage the contract best is liable to prevent certain risks from materialising, and should be financially liable for those risks should they materialise and cause the innocent party to suffer a loss¹⁰. They act as an effective way to manage contractual risk.

The practical and commercial significance of indemnities cannot be understated, however as already mentioned, there does appear to be conflicting views presented by the English courts regarding what remedies are available when an indemnity is breached. This article will now consider the different views presented by the English courts on the available grounds for innocent parties to claim when an indemnity has been breached, and whether it is a claim for debt or for damages. It is crucial to understand that 'this is more than a semantic difference'¹¹ as 'the answer is critical because it dictates the nature of the indemnified party's claim and thus whether the Damages Rules apply'¹². Appreciation for this distinction and how it is practically applied by the English courts has a real impact on commercial parties. Before addressing that debate, it is firstly important to briefly set out the difference between an action for debt and a damages claim.

⁷ M Bennett *Drafting Effective Indemnity Clauses* paper presented at the College of Law on 18 February 2016 p3

⁸ G Andrews and R Millett, *The Law of Guarantees* 6th edition (London: Sweet and Maxwell, 2012) at para. 1-012

⁹ Bennett *op.cit.* p4

¹⁰ *ibid*

¹¹ N D'Angelo 'The indemnity: It's all in the drafting' [2007] 35 *ABLR* 93 p107

¹² *ibid.* The Damages Rules referred to are the standard Common law rules that limit claims for damages, such the rule on remoteness and the rule requiring mitigation of loss.

What is a debt claim? What is a damages claim?

A debt claim arises where a party is liable to pay a fixed sum under a contract, and fails to do so¹³. The contract between the parties will normally be clear on the sum owed, and any claim will be based on the contractual obligation undertaken. An example of this is where a party who has done work sues for the agreed remuneration or bonus¹⁴. A simple understanding of a claim for damages is provided in McGregor on Damages, which states that there are three requirements for a damages award:

1. an award in money;
2. for a wrong;
3. which is a civil wrong.¹⁵

In contract law, damages will be awarded where there has been a breach of contract, and the payment of money will be awarded as 'compensation to the claimant for the damage, loss or injury he has suffered through that breach'¹⁶.

The importance of the distinction between the two is that a beneficiary of an indemnity may prefer to pursue an action for debt where there is a breach of that indemnity, rather than seek damages as claims for damages are limited by two important requirements:

1. the 'remoteness of loss' rule – a loss will only be recoverable if it arose in the usual course of things or the losses were contemplated by the parties at the time the contract was executed; and
2. the 'mitigation' rule – the innocent party will not be able to recover losses which he should have avoided or which he could have avoided had he taken reasonable steps.¹⁷

Certainly a party defending a claim for breach of indemnity may prefer to defend a damages claim and rely on the above two rules. Practically some parties may actually prefer to pursue a claim for damages because the amount being claimed does not need to be quantified at the time nor does there need to be proof that a demand for payment was made¹⁸. There are therefore different reasons why different parties may seek a particular form of remedy when an indemnity clause in a contract is breached. It is important to emphasise the practical significance of the debt-damages debate for commercial parties to a contract, and the need for clarity in English law in its resolution of disputes for breaches of indemnities.

Breach of an indemnity; debt claim?

As referred to earlier, the purpose of this article is to consider whether English law has a clear approach with regards to the interpretation of indemnities in instances of breach, and the basis on which a claim for that breach is considered in the courts. Bennett considers 'of fundamental importance jurisprudentially'¹⁹ and of 'somewhat practical importance'²⁰ whether the claim is one based on debt, or whether it is a claim for damages. There is the argument that English law recognises that a claim based on a contractual indemnity gives rise to a claim in debt. The ABM Amro Case saw a ruling by Mr Justice Flaux in the High Court which supports this approach. The claimant in the case, ABM Amro purchased the debts of its clients Jenk Sales Brokers Limited ("**JSBL**") under an agreement dated 30 June 2003. Each of the defendants, Ambrose McGinn, Ross Lawrance Beattie and Marcus Leek, were directors of JSBL. They entered into a deed of indemnity with the claimant (in the case of the first two defendants

¹³ *Chitty on Contracts*, edited by H. Bealer, 33rd edn (London: Sweet & Maxwell, 2018), Vol.1, at para. 27-002

¹⁴ *ibid*

¹⁵ *McGregor on Damages*, edited by Edelman, Colton & Varuhas, 20th edn (London: Sweet & Maxwell, 2017) at para.1-001

¹⁶ *Chitty on Contracts* op.cit. at para. 26-001

¹⁷ *ibid* at para. 26-002

¹⁸ R Zakrzewski 'The Nature of a Claim on an Indemnity' [2006] 22 *Journal of Contract Law* 54 p66

¹⁹ Bennett op.cit. p6

²⁰ *ibid*

in May 2007 and with the third defendant in December 2008), which included a conclusive evidence clause, which essentially extended liability from JSBL to the defendants. In May 2009, JSBL entered into administration. The claimant appointed an agency to collect outstanding debts from JSBL, and over two years the agency pursued collection of as much outstanding debt as possible. After those two years passed, the administrators of JSBL acknowledged in writing to the claimant that JSBL was still indebted to the claimant in the sum of £8,924,783. The claimant then sought to recover that outstanding sum from the defendants under the deeds of indemnity in the courts. The defendants argued that as their liability was secondary not primary, any liability that they had was discharged by material variations to the original agreement for the purchase of the debt. Further they also argued that the claimant had not taken the proper steps to collect and enforce the debts and also that the claimant was essentially estopped from relying on the agreement in respect of debts notified after 24 February 2009. The claimant served certificates of indebtedness on the defendants in October 2013 as part of its claim for sums owed and as conclusive evidence against the defendants. The claimant applied for summary judgment at the High Court. Flaux J, decided the case, holding that the inclusion of a conclusive evidence clause in the deeds of indemnity meant that the liability of the defendants was primary and not secondary. In addition, and crucially, the judge held that there was no obligation on the claimant to mitigate its losses nor could the defendants rely on the defence that their liability should be limited as a result of the claimant contributing to its own losses. This was because the liability owed by the defendants was primary and not secondary.

Importantly, the judgment in this case by Flaux J was emphasising that the claimant could recover monies owed by the defendants as a form of debt as it was a primary obligation, as opposed to pursuing a claim for damages. There is some analysis of the case which suggests that the decision of Flaux J was a consequence of the inclusion of 'wording in the conclusive evidence certificate clause which entitled the claimant, when arriving at the amount payable...to take into account all liabilities...and to make a reasonable estimate of any contingent liability'²¹, which has been suggested to support the argument that the sums owed was as a debt as it 'was not dependent upon any conclusive determination of liability of the Company [JSBL]'²². This is an important point, and the judge was clear in his analysis in determining that the claim for breach of indemnity in this instance was a debt claim. Evidently Flaux J considered the specific facts of the case in arriving at his decision, nonetheless the ruling delivered if considered without context and in broad general terms, could give the impression that English law is settled on this matter. Tedjani, in his conclusion to his review of indemnities in SPAs, states the following; 'An indemnity is a debt claim. The trigger is an agreed event and the remedy is an agreed sum'²³. This assertion presents a rigid understanding of the law and judgments in this area, and incorrectly ignores the inconsistency in the consideration of breach of indemnity claims by the English courts.

There are other rulings in the English courts that have considered indemnities, and support the proposition that a claim for breach of an indemnity is to be understood as a debt claim. In *Jervis v Harris*²⁴, a prominent case dealing with property law and more specifically repairing covenants for dilapidations, Lord Justice Millett, one of the three judges hearing the case, considered the indemnities at question, and gave a relatively detailed assessment of the position of indemnities under English law. He stated as follows;

"The short answer to the question is that the tenant's liability to reimburse the landlord for his expenditure on repairs is not a liability in damages for breach of his repairing covenant. The landlord's claim sounds in debt not damages; and it is not a claim to compensation for breach of the tenant's covenant to repair, but for reimbursement of sums actually spent.....The law of contract draws a clear distinction between a claim for payment of a debt and a claim for damages for

²¹ Sherman and Sterling 'Case Comment – United Kingdom: indemnity – conclusive evidence certificate' [2014] *Journal of International Banking Law and Regulation* p116

²² *ibid* p116-117

²³ M Tedjani 'Indemnities in private share deals' [2019] *Company Lawyer* 39 p46

²⁴ Ch. 1991 J.No.416

breach of contract.....a debt is a definite sum of money fixed by the agreement of the parties as payable by one party to the other in return for the performance of a specified obligation by the other party or on the occurrence of some specified event or condition...²⁵

Millet LJ, considering the facts of that case, was clear in his assertion that a claim for breach of the indemnity sounds in debt and not damages, although the esteemed judge appears not to have ruled in general terms. His decision represented another example of a breach of an indemnity being deemed to result in a debt claim, although the ruling did not go as far as Flaux J.

The decision of the Court of Appeal in the case of *Royscot Commercial Leasing Limited v Ismail*²⁶ (the “**Royscot case**”) is also a relevant authority in this area and supports the argument that English law recognises breaches of indemnities as giving rise to debt claims. Flaux J relied on this ruling in his judgment in the *ABM Amro Case*, establishing that where a claim for breach of indemnity was for a specific sum, it was a claim for debt. The background to the *Royscot case* is that the claimant was a leasing company that entered into an agreement with a company called *Mina Enterprises Limited*. The claimant would rent certain equipment to the company for a total amount of £31,449.20 to be paid monthly by the company. This agreement was entered into on 10 May 1988. At the same time, the defendant, Mr. Mohammed Ismail, who was a director of *Mina Enterprises Limited*, entered into an indemnity with the claimant. During the life of the contract, *Mina Enterprises Limited* went into liquidation, and the claimant repossessed the goods, as it was entitled to do under the agreement, and sold them at auction for £498.60. The claimant then also sought to bring a claim to recover the outstanding rental sum that was owed as a result of the early termination of the contract (minus the amount recovered at auction for the equipment). The defendant, having provided an indemnity to the claimant, was liable to pay what was owed. The defendant presented several arguments, including that the claimant had failed to properly mitigate its losses and therefore could not claim the amount alleged as a consequence. The matter ended up progressing to the Court of Appeal as stated earlier, where the judges decided to dismiss the appeal by the defendant. The judges recognised a breach of indemnity as resulting in a debt claim, and as a result the usual rules of mitigation and contributory liability that may arise in damages claims did not apply here. The actual judgement was written by Lord Justice Hirst, with Lord Justice Kennedy and Lord Justice Glidewell concurring. Hirst LJ considered the arguments of the claimant ‘correct as a matter of law’. The claimant had argued that;

“a claim under a contract of indemnity, such as this, is not a claim in damages at all, but is a claim in debt....Accordingly, it should not be open to a person providing an indemnity to challenge his obligation to pay under the contract of indemnity by reference to principles relating to the assessment of damages for breach of contract which have no application to debts.”²⁷

Emphasising the point later in his judgment, Hirst LJ added that ‘it is therefore, in my judgment, implicit in the majority decision that the rules of mitigation do not apply to a claim for a debt due’²⁸.

The above authorities show that there may be a clear thread of reasoning in English law which supports the position that a breach of indemnity will result in a debt claim. Judges have considered this matter, and there are a number of rulings which mandate that rules of mitigation and contributory liability should not apply to claims for breach of indemnity, which supports the debt claim approach. Despite evidence

²⁵ *ibid* p202

²⁶ [1993] WL 1465298. See also the decision of the High Court in the case of *Codemasters Software v Automobile Club de L'Ouest* [2009] EWHC 2361. The case concerned interpretation of an indemnity, and was heard by Mr Justice Warren in the High Court. In delivering his judgement Warren J included the following; “*The law, so far as I am concerned, is therefore that questions of mitigation do not arise under contracts of indemnity so as to give the indemnifier a defence to any part of a claim for which he would otherwise be liable under his indemnity.*” This would appear to support the debt claim approach, rather than the damages claim approach. See also the judgment of Lord Hoffman in *Caledonia North Sea Ltd v BT Plc* [2002] S.C. (H.L.) 117 p143 where he appeared to distinguish claims for breach of indemnity from breaches of contract stating “*But this is not a claim for breach contract. It is a claim to an indemnity for a liability...*” It would appear the distinguished Lord Hoffman was differentiating the nature of a breach of contract claim based in a remedy for damages, from the breach of indemnity claim.

²⁷ *ibid* p3. The learned judge stated, in response to this argument, ‘in my judgment this submission is correct as a matter of law’

²⁸ *ibid* p4

of this approach by the courts, the conclusion cannot be considered to be completely certain, and it will be demonstrated that there are decisions in the English courts that support the alternative view that breach of indemnities claims are damages based claims. Even some apparent proponents of the debt claim approach acknowledge the lack of absolute certainty in English law. Bennett, an Australian lawyer, considering the nature of indemnities under common law, but principally based on the English law rulings on this matter, provides tacit support for the debt claim approach, stating that ‘on balance, it seems recovery under a contractual indemnity is a right of reimbursement and not subject to the issues relevant to recovering damages....the claim is therefore more in the nature of a debt’²⁹. Note his support for this particular approach is not absolute, and his arguments are certainly relevant when focusing solely on the English law position on indemnities. There needs to be some acknowledgment of the complexity of the judicial approach to this issue, and the next section of this article will present English law authorities that support the damages based claims approach and highlights that complexity.

Damages for breach of an indemnity

The alternative approach under English law with regards to the breach of indemnities in contracts, is as mentioned above, that they give rise to claims for damages. There are some clear judgments by the English courts that support this approach.

The ruling in the Durley House Case and the decision in the ABM Amro Case were delivered within weeks of each other, and it is this contrast in approach by the High Court, on what appeared to be similar questions, that illustrates the complexity in this area of the law. The background to the Durley House Case is as follows. The claimant, Durley House Limited, had entered into a lease with Cadogan Estates Limited (“**Cadogan**”). The claimant had also entered into an agreement with Firmdale Hotels plc (the defendant), including a form of indemnity under which the defendant would pay for rent due under the lease to Cadogan. The lease terminated in 2012, and the claimant vacated possession owing a substantial amount of rent. Cadogan served a statutory demand on the claimant for the rent in September 2012, and brought proceedings against the claimant in County Court for the outstanding sums owed as rent and other payments that it claimed were due. Judgment was found in favour of Cadogan for arrears of rent in the sum of £2,129,830, in addition to damages and interest. That judgment has not been satisfied, the lease was the only asset of the claimant and the claimant was subsequently an insolvent company. Cadogan obtained possession of the property in January 2013. The claimant then sought to rely on the agreement in place with the defendant in order to ensure payment of the outstanding rent due by the defendant.

Stephen Morris QC, then sitting as a Deputy High Court judge, delivered the judgment. He considered many different issues including the validity of the indemnity, in arriving at his conclusion in this judgment, however the important aspect of his ruling to consider here is in relation to the remedy available for breach of the indemnity, and the judge made some interesting statements on this in his decision. He stated;

“It is certainly the case, that the English authorities are at one in taking the view that the remedy for breach of a contract of indemnity is damages, rather than one for a contractual sum due (i.e. debt)”³⁰.

This was quite a bold and clear statement by the judge, and it appears very difficult to reconcile his statement with the ruling of the High Court in the ABM Amro case. Morris QC concluded “that the Defendant is liable to the Claimant for damages for breach of the obligation to indemnify”³¹. Evidently the outcome from this particular case was that breach of an indemnity should clearly be seen as giving rise to a claim for damages in favour of the recipient of the indemnity. There is the argument that ‘the

²⁹ Bennett op.cit. p8

³⁰ n6 above p29

³¹ ibid p30

policy considerations reflected in the doctrines of mitigation and remoteness...have proved strong enough for the courts to seek to incorporate them into many indemnities as a matter of construction'³². Applied here, the suggestion is that some courts may be driven by policy considerations, such as a 'desire to incentivise the avoidance of avoidable loss'³³, and therefore incorporate the principles of remoteness and mitigation into their decision regarding a claim, and this has had an impact, explaining why some courts have determined that a breach of an indemnity entitles a party to a claim for damages rather than debt. This is certainly an interesting argument, and it is difficult to disprove. However, notwithstanding the reasoning for those decisions by the English courts, the fact they have taken that approach in some instances demonstrates the lack of consistency in this area.

The judge in the Durley House Case also relied extensively on a previous case in English law, where the House of Lords considered issues regarding indemnities at length. This case was *Firma C-Trade SA v Newcastle Protection and Indemnity Association*³⁴ (the "**Fanti Case**"). Note that this particular dispute was joined with another for consideration by the Law Lords.

The background to the Fanti Case was a cargo claim in respect of the loss of cargo on a motor vessel. The owners of the vessel had entered it in the P&I club, which it was a member of, and which protected and indemnified the members against losses for liabilities on the ship. The member did not defend itself against the claim from the cargo owners, and therefore judgment was entered against it in default, and the cargo owners were awarded damages with interest. However the judgment was not satisfied, and the member was then ordered to be wound up by the Companies Court. The cargo owners then brought an arbitration claim against the P&I club, seeking to rely on an indemnity against them under the Third Parties (Rights Against Insurers) Act 1930, as the member had been wound up. The arbitrator decided in favour of the P&I club, however this ruling was appealed through the courts. The claimant in this appeal is the cargo owner and the defendant is the relevant P&I club. The case considered complex issues of marine insurance law, and it is useful to note that the Law Lords accepted the arguments of the defendant, and upheld the 'pay to be paid' condition. The important aspect of this case for this article are the judgments delivered specifically on the issue of indemnities, which will be extracted from the decision for consideration here.

Lord Brandon, as part of the background to the case before the actual judgments of the judges, included the following declaration; "The starting point is the rule of the common law...the common law regarded a contract of indemnity as sounding in damages rather than debt"³⁵. This presentation of the position in the common law regarding indemnities is evidently distinct from the previously considered rulings that present the contrary position that a breach of an indemnity gives rise to a claim in debt. Lord Goff, in his judgment in the Fanti Case, also suggested consistency with the presentation by Lord Brandon, and his words were also significantly relied upon in the judgement delivered by Morris QC in the Durley House Case. Lord Goff stated the following;

*"...a promise of indemnity is simply a promise to hold the indemnified person harmless against a specified loss or expense. On this basis, no debt can arise before the loss is suffered or the expense incurred; however, once the loss is suffered or the expense incurred, the indemnifier is in breach of contract for having failed to hold the indemnified person harmless against the relevant loss or expense."*³⁶

These words by the esteemed judge are a clear rejection of the alternative perspective that indemnities give rise to a debt claim, and support the damages claim argument. However, while the Fanti Case 'has been supported in several subsequent cases, it is by no means universally agreed that all indemnities must necessarily imply a promise to "hold harmless", or even that the use of the expression

³² D Foxton QC 'How useful is Lord Diplock's distinction between primary and secondary obligations in contract?' [2019] *Law Quarterly Review* 249 p 261

³³ *ibid*

³⁴ [1990] 3 W.L.R. 78

³⁵ *ibid* p16

³⁶ *ibid* p35-36

“hold harmless” in an indemnity necessarily results in a construction that a claim is to be characterised as a claim for unliquidated damages in respect of a breach of that promise³⁷. The law has not yet definitively resolved this question. Reynoldson appears to go further and states ‘an indemnity is also different to a right to claim damages’³⁸. However a deeper analysis of her position suggests that indemnities should not be viewed solely as provisions giving rise to claims for damages, but should be seen as broader than that. This appreciation for the lack of rigidity in determining breach of indemnity claims is important, and has formed the basis of this article. This article has sought to assess the state of play in English law on this matter, and has demonstrated that there are divergent approaches that the English courts have followed on this specific question of whether a breach of indemnity results in an action for debt or damages. There are respected judicial authorities for both positions, often heavily dependent on the facts of the case.

In his article on Lord Diplock’s distinction between primary and secondary obligations in contract, David Foxton QC looks at the application of that distinction in the context of indemnities³⁹. A full breakdown and analysis of those terms is beyond the scope of this article, however it is useful to note that the terms primary and secondary obligations were used by Flaux J in his decision in the ABM Amro Case. In essence, Lord Diplock based his development on John Austin’s distinction between rights and duties that are principal or primary, and rights and duties that arise as a result of the violation of other rights and duties (and are therefore to be considered secondary)⁴⁰. Debt claims are deemed to arise as a result of a breach of a primary obligation; a sum is owed under the contract and therefore the party who owes the sum has a primary obligation to pay. Claims for damages are generally perceived to arise as a result of a secondary obligation; a duty is owed under a contract and failure to perform that duty means that the party owes damages as a secondary obligation to make good that failure to perform the primary obligation duty. Foxton recognises that ‘the application of the distinction between primary and secondary obligations has proved particularly fraught in the context of contractual indemnities’⁴¹. He recognises the difficulty in developing a clear rule on how breach of indemnity claims should be classified under English law, and the rulings from the various cases presented supports this recognition. Although Foxton does then state ‘the dominant approach has been to classify the indemnitee’s right under a contractual indemnity as a secondary right’⁴², as he understands it to mean more a damages type approach. This would be supportive of the decision arrived at in the Durley House Case, and highlights the significance of the comments made as part of the judgment by the most senior court in English law at the time (the House of Lords) in the Fanti Case, as significant in this area. However his reference to a dominant approach doesn’t undermine the view that there is a lack of consistency and is not necessarily contradictory of his earlier statement that this area of the law is ‘fraught’. In fact, Foxton does later state that ‘it is suggested that there is a distinction between claims to enforce indemnities which are in the nature of debt and those which are in the nature of a claim for damages.....However, the practical application of that distinction and the consequences of the classification are not always satisfactory’⁴³. Foxton is in essence recognising that English law is unclear on indemnities, and the resolution of the debt-damages distinction by the courts is currently inadequate.

There does not appear to be a clear single approach followed in English law on this question. It is apparent that at present, neither the debt claim approach nor the damages claim approach is always the correct approach for determining party liability for breach of a contractual indemnity. The facts of the case, and the construction of the indemnity are very important in resolving this question, and it is this fact dependent approach that often appears to be the overriding sentiment of the courts in resolving questions regarding indemnities. It is probably fair to say that notwithstanding the lack of consistency

³⁷ N D’Angelo op.cit. p103

³⁸ M Reynoldson ‘Indemnity clauses – what are they, how do they work and how to make them work for you’ [2013] 24 *ILJ* 186 p4 as accessed via LexisNexis on 30 May 2019.

³⁹ D Foxton QC op.cit. p249. Lord Diplock developed this distinction between primary and secondary rights or obligations under a contract in the case of *Hardwick Game Farm v Suffolk Agricultural Poultry Producers Association Ltd (SAPPA)* [1966] 1 W.L.R 287; [1996] 1 All E.R. 309.

⁴⁰ *ibid* see John Austin, *Lectures on Jurisprudence or the Philosophy of Positive Law* (London: John Murray, 1885)

⁴¹ *ibid* p258

⁴² *ibid*

⁴³ *ibid* p259

and the apparent lack of absolute clarity, the courts have not been haphazardly applying the debt or damages remedy to resolve claims for breach.

Understanding the different approaches

This article has so far demonstrated the different approaches that the English courts have taken with regards to dealing with breach of indemnity claims. There are two general remedies that the courts have applied, the debt claim and damages. What appears clear from reviewing the judgments is that the term indemnity covers a very wide range of different terms, and recognition of that is fundamental to understanding how the courts can arrive at different conclusions when ruling on their breach. The suggestion that ‘as it is a creature of its drafting, the indemnity is capable of infinite flexibility’⁴⁴ may appear to be too extreme a view, but it does help underline the difficulty in determining whether there is a correct approach, and further explains why the courts deliver rulings that do not appear to fit within a simple and consistent rule. Interpretation of the indemnity is of utmost importance when determining whether a breach gives rise to a claim in debt or for damages.

There are other instances where the English courts have considered the question of the interpretation of contracts, and this is relevant to consider here with regards to the interpretative approach followed by the courts in dealing with the breach of indemnities. In the case of *Wood v Capita Insurance Services*⁴⁵, the UK Supreme Court considered the question of the interpretation of indemnities in contracts. The case concerned the sale of share capital in a company called Sureterm Direct Limited (“**Sureterm**”) by the owner of the shares Mr Wood, to Capita, who were the purchasers. A Share Purchase Agreement was executed by the parties in 2010, and included an indemnity, given by the purchasers Capita, in favour of Mr Wood. The indemnity effectively stated that Mr Wood would pay Capita for any losses that Capita suffered as a consequence of any action brought against Sureterm due to its selling process prior to the completion date of the sale transaction. An internal complaint was made shortly after the purchase about Sureterm’s sale process, the consequence of which was that Sureterm agreed a remediation plan with the FSA to pay compensation to affected customers. Capita then attempted to enforce the indemnity, which Mr Wood contested on the basis that the incident fell outside of the scope of the indemnity as the compensation had been paid as a result of an internal complaint and not a complaint made by an external party. As a result, Mr Wood claimed, the indemnity could not be said to have covered this sort of situation. The Supreme Court agreed with Mr Wood and dismissed the claim by Capita. Critically, it clarified the approach under English law to interpret indemnities, emphasising the importance of considering the drafting and literal meaning of the words presented, in addition to the commercial context of the indemnities and the nature of the contract in which the indemnities are set out. The indemnity should be considered in the context of ‘business common sense’⁴⁶ and in conjunction with the other provisions in the contract which helps shape and clarify its meaning.

This recent decision of the Supreme Court highlights the complexity in the interpretation of indemnities by courts under English law. It is important to note that the case serves as authority for interpretation generally, however as the subject to be interpreted here was an indemnity clause, it is a very useful reference point for the application of those developed contract interpretation rules to indemnities, in English law. The Supreme Court emphasised both the form and context of the indemnity as drafted in determining what it means, and the courts have steered away from rigid rules on interpretation. The decision confirmed ‘the validity of both literal and contextual approaches’ to interpretation⁴⁷. This general approach is relevant in considering how the English courts have approached remedies for

⁴⁴ N D’Angelo op.cit. p107

⁴⁵ [2017] UKSC 24

⁴⁶ Maitland Chambers case comment *Wood v Capita Insurance Services Ltd* accessed at

<https://www.maitlandchambers.com/information/recent-cases/wood-v-capita-insurance-services-ltd> on 30 May 2019

⁴⁷ C Dowling and A Denhom ‘Literal or Contextual? What is the Correct Approach to Contractual Interpretation?’ *Oxford Law Faculty Blog* (26 April 2017) accessed on 5 May 2019

breach of indemnities, as those courts attach considerable significance to the form of the indemnity presented in their analysis. In determining whether the indemnity gives rise to a claim in debt or damages, the drafting of the indemnity is thoroughly reviewed by the court, and ultimately this makes it difficult to argue that English law has developed a single consistent rule that would apply in all cases regarding breach of an indemnity.

The current state of English law appears to support the analysis in *Chitty on Contract*, which states that ‘the scope of the indemnity will therefore depend upon the wording of the particular clause and the intentions of the parties regarding it to be collected from the whole of their agreement’⁴⁸. In response to the question whether breach of a contractual indemnity gives rise to a debt claim or a claim for damages, the position in English law appears to be that ‘the answer depends on how an indemnity is to be construed contractually’⁴⁹. The evidence from the case law analysed in this article suggests that there does not appear to be a clearer response to the question than that.

In an attempt to narrow the scope slightly from a case by case judicial interpretation on the form of an indemnity, in determining whether breach gives a right to debt or damages, there has been some suggestion that the decisions fit within an understanding of indemnities that recognises broadly three groups: a reimbursement indemnity for a clear and specified sum which gives a right to a claim for debt; a reimbursement indemnity for a sum that is unspecified which gives rise to a damages claim; and finally a hold harmless indemnity which also gives rise to a damages claim⁵⁰. This is certainly a useful analysis for practitioners, and could be said to provide parties with some general guidance in understanding indemnities and the consequences of adopting them in a contract. Crucially though, this attempt to develop some structure to understand indemnities is an acceptance that English law often perceives and interprets indemnities differently, which is not necessarily a bad thing, provided the courts are very careful in their analysis about why certain decisions are made.

Courtney emphasises this point, recognising that ‘contractual indemnities do not all possess the same set of characteristics’⁵¹, and this highlights the difficulty in applying rules about whether breach of those indemnities give rise to debt claims or damages claims. A determination that the courts should make a choice and apply a single view of indemnities as either giving rise to debt claims or damages claims for the sake of consistency is not particularly useful nor desirable. Such a simple approach would fail to capture the complexity of indemnities and would therefore not lead to the correct judicial outcomes in disputes. Courtney eschews the debt-damages approach in reviewing indemnities, and prefers instead to identify indemnities as either: a promise of prevention of loss, or a promise for compensation for loss⁵². The determination of whether an indemnity when breached gives a right to debt or damages should not be the focus of judicial enquiry of indemnity provisions generally, but rather the nature of the indemnity should be the focus. In essence, Courtney is accepting that the debt-damages question is not settled, nor should it necessarily be settled in absolute terms. The courts should not look to resolve the question of whether a breach of indemnity always results in a debt or a damages claim, nor should the courts view indemnities as being debt based or damages based. Both remedies should be available, and their application should be as a result of the interpretation of the indemnity in question. The complexity of the law of indemnities mandates a nuanced approach rather than a simple labelling of all indemnities or a particular type of indemnity as always being remedied by claims for debt or damages when breached. Courtney even accepts that his classification of indemnities as preventative or compensatory, in an attempt to establish a framework for review is ‘a useful schema for analysis but it does have limits’⁵³. He states further that ‘some indemnities appear to be composite or, perhaps,

⁴⁸ *Chitty on Contracts* op.cit. at para. 15-018

⁴⁹ N D’Angelo op.cit. p102

⁵⁰ Blake Morgan *Indemnities: a debt or damages claim?* (1 February 2016) p5

⁵¹ W Courtney ‘The Nature of Contractual Indemnities’ (August 2011) *Sydney Law School Legal Studies Research Paper No. 11/41* p2

⁵² W Courtney *Contractual Indemnities* (Hart Publishing 2015) see chapter 2 for a comprehensive analysis

⁵³ W Courtney n51 above p17

protean⁵⁴ and this does cause further complication. His description of indemnities is pertinent, and should highlight further the complex nature of indemnities under English law.

Rafal Zakrzewski, uses different terminology, but is in agreement with Courtney's general analysis. He recognises that 'there may be two different types of indemnity which potentially give rise to two different types of claim'⁵⁵. He breaks this down to different types of primary rights, a 'prevent loss' indemnity which when breached will give a party a right to claim on a secondary obligation to pay damages, and a 'redress loss' indemnity which gives parties a right to a debt claim⁵⁶. His suggestion is that by accepting that indemnities can give rise to these different remedies, 'we may be on our way towards solving the puzzle'⁵⁷. This is consistent with arguments that the focus should be on proper analysis and interpretation of the indemnity to ensure that the appropriate remedy is available for breach, rather than attempting to determine what form of remedy is available for breach of an indemnity clause as a rigid rule in English law. The courts should steer away from judgments that present indemnities as falling into rigidly defined categories, and instead embrace a more nuanced approach that accepts the differences in indemnities and the need for the courts to have some flexibility in determining the appropriate context specific remedy for breach.

Any attempt to describe or understand an indemnity should look to the root of the indemnity and the content, rather than focus on the choice of remedy as its defining characteristic. Certainly there have been some judgments in the English courts prior to *Wood v Capita Insurance Services* that have aided confusion, by failing to sufficiently emphasise how fact dependent their rulings were. The significance of that ruling is that the highest court in the land, the Supreme Court, emphasised the importance of the interpretation of indemnities in determining how they apply, and clarified the approach to that interpretation. It does not appear that there will be any change on the horizon to the current situation in English law to judicially settle matters. The courts should directly address this question, and apply the more flexible and realistic proposals of Courtney or Zakrzewski. This would aid clarity and demonstrate a more logical and less confused understanding of this area in English law. Ultimately the responsibility is with those drafting indemnity clauses in contracts to ensure that they are drafted as clearly as possible and the available remedies are as clearly defined as possible on paper.

Conclusion

The purpose of this article was to determine whether under English law a breach of indemnity gave a party a right to bring a claim for debt or a claim for damages. It has been shown that there is support for both approaches in the English courts. There have been judgments that recognised breaches of indemnities as giving rise to debt claims, and there have also been judgments that pursued the damages claim approach. The clearest evidence of that apparent judicial division are the High Court rulings in the *ABM Amro Case* and the *Durley House Case*, in the same year. The basis for that lack of judicial coherence appears to be the very complicated nature of indemnities, and the fact that the construction of indemnity provisions within contracts differ wildly. As a consequence, it has been difficult for the English courts to pursue only one approach, and it is ultimately preferable that cases are decided in a manner cognisant of the complexity of this area. What has been missing is direct judicial recognition of that complexity in judgments, and the development of a consistently applied set of rules that attempt to capture that complexity.

The answer to the question whether English law recognises breaches of indemnity as sounding in debt or damages is that it can apply either remedy depending on the situation, and that lack of rigidity is not a bad thing. What has been made clear in this article is the importance of the drafting of the indemnity and the commercial context of the contract and relations between the parties. The Supreme Court has

⁵⁴ *ibid*

⁵⁵ R Zakrzewski *op.cit.* p55

⁵⁶ *ibid*

⁵⁷ *ibid* p70

recently emphasised the importance of context and construction to properly interpret an indemnity clause. The courts generally should now look carefully at these factors in their assessment of the indemnity, and should hopefully more deliberately and audibly use that interpretive exercise to develop rules on this subject.

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